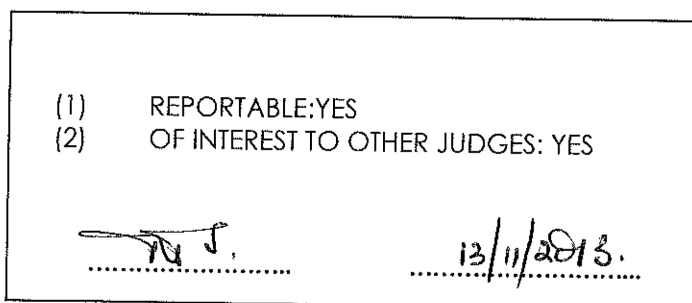
REPUBLIC OF SOUTH AFRICA

THE HIGH COURT OF SOUTH AFRICA

GAUTENG LOCAL DIVISION, JOHANNESBURG



(1) REPORTABLE:YES
(2) OF INTEREST TO OTHER JUDGES: YES

13/11/2013.

CASE NO 2009/16903
RTS/B20/P161

In the matter between:

TLOTLISA SECUTITIES (PTY) LTD **PLAINTIFF**

AND

FOVEROS INVESTMENT HOLDINGS (PTY) LTD **FIRST DEFENDANT**

CARLSSON, MICHAEL GEORGE **SECOND DEFENDANT**

JUDGMENT

SUTHERLAND J:

Introduction

1. The principal issue in this case is whether or not the second defendant (Carlsson), who was the former managing director of the plaintiff, breached his fiduciary duties towards the plaintiff, and by so doing, is liable in damages to the plaintiff for R 1,233,676.26. The first defendant (Foveros) had been deregistered by the time of the trial and the action proceeded against Carlsson only.

2. The plaintiff was, at the relevant time, a stockbroker and member of the Johannesburg Securities Exchange (JSE). Foveros traded, *via* the plaintiff *qua* client, in Single Stock Futures (SSFs) on the South African Futures Exchange (SAFEX). It defaulted on its contractual obligations to the plaintiff to make good a loss on SSF trading as at 31 August 2008. The sum of that loss is the damages now claimed from Carlsson.

3. Carlsson and all other directors of the plaintiff traded for their *de facto* own account, via the plaintiff, in equities and other securities, including SSFs. Foveros was controlled by Carlsson and all its dealings with the plaintiff *qua* client were conducted through Carlsson personally. Foveros was treated as the *alter ego* of Carlsson and was dealt with as a 'staff account'. Carlsson, thus, wore two hats in the relationship between Foveros and the plaintiff, ie as a client and as managing director of the plaintiff. This distinction is important because whatever contractual obligations that Foveros had towards the plaintiff and whatever liability it had towards the plaintiff in respect of the damages claimed, this action against Carlsson in person, does not rely thereon. This action is founded exclusively on the *sui generis* relationship between the plaintiff and Carlsson *qua*

managing director. (As to the nature of a fiduciary duty see: *Phillips v Fieldstone Africa (Pty) Ltd 2004 (3) SA 465 (SCA) per Heher JA at [29] – [33]*)

4. It is necessary to explain how Foveros came to be indebted to the plaintiff in the sum claimed. The indebtedness of Foveros, in that sum, is not in dispute, although the contention is advanced that there is no proof of damages were suffered by the plaintiff in that sum, an aspect which is addressed later. Hardly any material facts are in dispute.

The basic dynamics of SSF trading

5. An extensive description of SSF trading appears in the judgment of C J Claassen J in *ABSA Bank Ltd v Ukwanda Leisure Holdings (Pty) Ltd (Unreported; Case no 2009/35416, 2013/09/09*).

6. In essence, a person who wants to invest in publicly traded equities on the JSE can do so only within the trading rules laid down by the JSE. In this matter the only relevant species of tradable investment is SSFs. Despite the very elaborate rules in place to facilitate the SAFEX, the basic dynamics are straightforward and a detailed traverse of the rules is unnecessary.

7. Trading in SSFs is akin to gambling on uncertain outcomes. As its label indicates, the investor is challenged to guess the future. A SSF is a kind of 'derivative' which means that it is an invention of the mind which is related to something tangible, but distinct from it. The idea underpinning SSFs is that a sum of money can be staked on the daily quoted price movements of a given listed public company's shares, without having to buy any of

those shares. Thus, by putting a sum of money into a dedicated account with a stockbroker, the investor client instructs the broker to buy specific SSFs related to a nominated company's shares. The broker, so instructed, buys the SSF on the investor's behalf by paying cash to the financer of the SSFs, usually a bank, who like the broker is also a member of SAFEX.

8. If the price of the underlying share goes up, so does the value of the SSF and the investor scores. If the price drops so that the value of the SSF falls below the attributed value, the investor loses the bet and must pay in the difference. This difference is called a 'variation margin' in stockbroker jargon. The bet is called every day and the amount deposited in cash must match the value attributed to the SSF. In a market where the underlying share price is on the rise, a positive balance builds up to the credit of the investor, and is available to be withdrawn as profit or reinvested in more SSFs. In a declining market, the hapless investor has to top up every day to maintain the equilibrium between the SSF value and the cash in the dedicated account.

9. The heart of this controversy relates to the mechanics of topping up the dedicated account in a declining market. Because the ultimate creditor, the bank, deals in SSFs only with a stockbroker and in turn the investor deals only with the stockbroker, who acts as the investor's agent, the dynamics of the trading play out at two distinct levels. Consequently, two sets of practises apply to the trading. The SAFEX rules govern the relationship between the bank (called the clearing member) and the broker (the non-clearing member). The relationship between the broker and the investor is governed by a contract concluded between them. In this set of arrangements, where a topping up is due, the broker pays the

bank by a given deadline, and then the broker looks to the investor client to make good that exact sum within the deadline.

10. The important dimension inherent in these relationships is that the broker is exposed to the risk of its investor clients not paying in time to back up the payments the broker has made, as agent of the investor, to the bank. Self evidently, this is a foreseeable risk. Accordingly, the contract between a broker and its investor client provides that if the investor does not pay timeously, the broker can 'close out' the 'position' which is stockbroker jargon for selling off the investment and halting the risk of escalating loss. The broker does not need the permission of a defaulting investor to do so and the authority to do so serves primarily to protect the broker from embarrassment in relation to the clearing member. If an investor client does not pay up to the broker any outstanding sum owing by the investor client to the broker, that sum paid by the broker is deemed to be a loan by the broker to the client. The plaintiff had precisely such a contract in place with Foveros.

11. As alluded to above, what happened in this case was that Foveros stayed in a declining market, did not top up, and when its positions were closed out, the plaintiff was left with an unrecovered sum in the amount now claimed.

What is the fiduciary duty relied upon?

12. It is useful at the outset, to circumscribe the fiduciary duty which Carlsson had towards the plaintiff so that the evaluation of the facts can be related to the true point of the enquiry.

13. That Carlsson, *qua* director, owed a fiduciary duty to the plaintiff is not disputed. However, certain lines of argument on behalf of Carlsson seemed to be muddled about what and to whom that duty was owed. Clarification is necessary.

    13.1. First, the plaintiff was not a partnership, and the fiduciary duties that directors owed were not to one another but *to the company*. To belabour the point, the company is the body of shareholders to whom the directors are accountable. Carlsson was not a shareholder of the plaintiff. The significance of this point is that any co-responsibility in any proven breach of fiduciary duties by other directors is a complete irrelevance.

    13.2. Second, the case for breach of a fiduciary duty is premised on Carlsson being *able to prevent the loss* occasioned by Foveros's default, by acting within the scope of his role as Managing director, and thus had a concomitant duty to do so act. To stress the point, the contention is that Carlsson, *qua* Managing director was able to prevent the loss, not Carlsson *qua de facto* client was able to prevent the loss, albeit that he could also have done so *qua* client, by, eg, paying in the variation margin or choosing to voluntarily close out Foveros's position.

14. As to how Carlsson, *qua* managing director, could have brought about that prevention of loss, the plaintiff's case is that it could have been achieved by invoking the plaintiff's rights to unilaterally close out Foveros's position at a moment when the losses were relatively modest. It is not in dispute that Carlsson could have done so, nor that he chose not to do so. In dispute, is purely his culpability, if any.

The origins of the Claim

15. The entire trading history of Foveros is recorded, transaction by transaction. The account is common cause, including the balance outstanding due by Foveros to the plaintiff on 31 August 2008 when the final positions were closed out. The only witness in the trial was Malan Saaiman, the financial director of the plaintiff.

16. The details of the events of July – August 2008 reveal the extent of the disregard by Carlsson of his fiduciary duty to protect the plaintiff against exposure to the risk of its investor clients defaulting, and the plaintiff being left out of pocket. The explanation for that course of conduct is his decision to prefer his own interests as investor over the interests of the plaintiff, and his choice to exploit the slackness in the application of the plaintiff's own rules in order to burden the plaintiff with a risk that Foveros (ie, himself *qua* investor) wished to take, but could not or would itself meet and pay for.

17. The market in SSFs had been on the rise until about 2007, when a general malaise in equities around the world began to manifest, which was triggered, as is well known, by the derivatives market being stretched so broadly that, at last, the vacuity of its conception was visible to all. By 2008, the loss of confidence rendered the market volatile and dangerous. However, the plaintiff had become accustomed to a rising market and, it can be supposed, fell victim to complacency, manifested, more especially, by the habit of indulging its clients and not insisting on timeous toppings up. This slackness was applied to the staff accounts no less than the arms length clients.

18. Thus it was, that when the market went into terminal decline, the plaintiff found itself with a huge overdraft because it had been settling the indebtedness to the clearing member, the bank, but was not being reimbursed by its clients, including its own staff clients, timeously or at all, being satisfied, in part, to rely on holding other equities of clients as collateral security. The value of those equities was also imperilled by the market collapse.

19. Malan Saaiman, who was the designated SAFEX compliance officer, alive to the risk, sent an email to the other directors on 7 July 2008. The tone was intemperate and emphatic and constituted an alarm that the plaintiff's financial predicament demanded immediate remedial attention. It addressed the failure of the clients to top up their falling positions and the intolerability of the plaintiff carrying the clients. He pointedly drew these concerns to the attention to those staff who were trading in SSFs, and who had not topped up, and who were, by such omission, like the arms length clients, contributing to the scale of the plaintiff's risk. Carlson was among the staff so addressed.

20. In the weeks that followed several client positions were closed out, and the plaintiff's risk diminished. However, Foveros carried on trading as usual. It neither topped up nor closed out its positions. On 17 July Foveros extracted R24,000 from the trading account whilst a cash deficit of R1.4 million was reflected. As late as 28 July, in an email, Carlsson acknowledged that Foveros was the largest SAFEX risk to the plaintiff, and vainly promised to meet a deadline for resolution by 'next Friday'. It did not happen. A show-down meeting among the directors took place to address several issues. The minutes reflect that Carlsson was not able or not willing to pay any cash in to resolve the risk to the plaintiff; discussions include references to other forms of forfeiture by Carlsson to

make good losses. The exact terms of engagement, as noted in the minute, remain obscure because Carlsson chose not to testify to explain his conduct. Eventually, the board intervened and compelled a close-out of Foveros's positions on 31 August. The sum owing to the plaintiff is the sum of the claim.

21. The evidence of the Foveros trading history shows that up until on 2 July 2008, the overall net state of the account was positive with a credit balance of some R1.5 million. Thereafter the net status was variable but opportunities to bale out of the investment with no loss or modest loss presented themselves from time to time until 18 July and once again on 1 August. Thereafter the spiral was uniformly downward. These opportunities occurred after the 5 July alarm by Saaiman. The trading pattern reflects that Foveros took no heed of the alarm and traded on regardless of the risks, not least of all to the plaintiff, who was carrying the burden of the disbursements in respect of the variation margins.

22. Moreover, Carlsson, responsible for those decisions *qua* investor quite plainly preferred to be bullish and exploit the slack practice of the plaintiff of letting its clients expose it to risk rather than putting the plaintiff's interests first. It is the clearest demonstration of a conflict of interest in which Carlsson chose to put himself first. The role of director, and more acutely of managing director, is to take steps to conduct the business of the company to its advantage and to 'take reasonable care' of the affairs of the company. (See: *Du Plessis v Phelps 1995 (4) SA 165 (C) at 170C*) Carlsson's conduct illustrates the opposite of 'reasonable care'

23. The breach by Carlssson was articulated in the particulars of claim as having taken the form of allowing Foveros to keep on trading after 5 July and that he did not insist on a close-out when Foveros did not top up. The defence put up by Carlsson is twofold:

    23.1. First, that the plaintiff's self imposed rules about insisting on timeous topping up or unilateral close-outs were not strictly applied and clients were, routinely, allowed to remain in deficit of their obligations to the plaintiff, during which time the plaintiff financed the disbursements to the covering member in respect of variation margins. Thus, what Foveros did was within the bounds of actual practice, and was business as usual.

    23.2. Secondly, that Saaiman, the compliance officer of the plaintiff was remiss in not closing out the position of Foveros at an earlier time, regardless of the supine attitude of Carlsson *qua* managing director, and thus, if loss was suffered, Saaiman was derelict in his duty and was the cause of the loss, not Carlsson.

24. These defences need only to be stated to expose their poverty. The decision to allow slackness by the plaintiff in following rules designed to protect it and which slackness imperilled the interests of the plaintiff in relation to defaulting clients, is a decision for which Carlsson was responsible, together with every other director to failed to take steps to resist it. To point to this lapse in sound judgment is no defence at all. Whether or not a measure of culpability and thus a breach of a fiduciary duty can be located at the time the slackness was first allowed is not especially important, as the particular culpability relied upon is the failure *to stop the slackness* in the face of circumstances prevailing during mid 2008, when, whatever conceivable justification may have existed for relaxation of the

rules during a rising market was demonstrably no longer valid or prudent. Carlsson sacrificed the plaintiff's interests.

25. As to the defence of abdication of responsibility to take the initiative to Saaiman, the idea is bereft of cogency. In *Bishopsgate Investment Management Ltd (In Liq) v Maxwell (No 2) [1994] All ER 261 (CA),* the director transferred shares for no value to another company of which he was a director. It was held the alienation was the exercise of a fiduciary power. Hoffmann LJ then went on to say:

> " If a director chooses to participate in the management of a company and exercises powers on its behalf, he owes a duty to act bona fide in the interests of the company. He must exercise the power solely for the purpose for which it was conferred. To exercise the power for another purpose is a breach of his fiduciary duty. It is no answer that he was under no duty to act in the first place. Nor can Mr Ian Maxwell be excused on the ground that he blindly followed the lead of his brother Kevin."

26. The underlying notion that Carlsson was not alone to blame might have merit, but in the absence of testimony to lay a platform for such a finding, it is inappropriate to embark on such an exploration. Moreover, the utility of such a premise is absent. As I have stressed elsewhere, the true point of the enquiry is not who caused the slack practice but whether or not Carlsson could have ended the practice, ended the risk and prevented the loss. His peculiar double role undoubtedly empowered him to end this risk and he was reckless as regards the plaintiff's interests in not doing so.

27. Of no little significance is Carlsson's decision not to testify and to lay bare what his thinking was at the time and try to justify the decisions he took. The inference can only be that he has no plausible justification to offer.

Can Carlsson avail himself of the relief provided for i Section 244 of the Companies Act 61 of 1973?

28. Carlsson invoked the Section, the relevant portion of which provides:

> " In any proceedings for .....breach of duty or breach of trust against any director.....it appears to the court that the person concerned is or may be liable in respect of negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that having regard to all the circumstances of the case, ...he ought to be excused for the negligence, default, breach of duty or breach of trust, the court may relieve him, either wholly or partly, from his liability ....".

29. The key elements in this Section to warrant relief are 'honestly and reasonably.' Both attributes need to be demonstrated. On the facts described above, Carlsson's conduct cannot be described as reasonable. There is a view articulated by in *Henochsberg on the Companies Act, [ie on Act 61 of 1923; issue 28) at p462* that a generous interpretation of reasonableness is appropriate. Reference is there made to the judgment of *Stegmann J in Ex Parte Lebowa Development Corporation 1989 (3) SA 70 (T) at 108 C – 109 A:*

> " When the company itself (or its liquidator or judicial manager) seeks a remedy against a director or other officer for damages caused by his negligence, the Court has the power provided by s 248 to grant the director or other officer relief from the ordinary consequences provided that he has acted not only honestly but also reasonably, and that in all the circumstances it appears to the Court that he ought fairly to be excused. The provision therefore envisages a situation in which a director's act or omission may be found to be both 'negligent' and 'reasonable' at one and the same time. Since an act (or omission) is only 'negligent' if it is something which would not have been done (or left undone) by a reasonable man acting reasonably, there is some uncertainty as to what the Legislature can have had in mind when it empowered the Court to relieve a director from liability to the company for his negligence, provided that he acted 'reasonably'. The concept of 'reasonable negligence' appears on the face of it to be self-contradictory.

A predecessor of s 248 was applied in Niagara Ltd (in Liquidation) v Langerman and Others 1913 WLD 188. The company's liquidator sued its directors for the recovery of amounts paid out of the company's funds as commission in terms of an improvident contract which the directors were held to have been grossly negligent to have concluded. The directors contended that they had acted honestly and reasonably and that the circumstances were such that they ought fairly to be excused by the Court in terms of s 210 of Act 31 of 1909 (a predecessor of s 248 of Act 61 of 1973). Curlewis J held that they had acted with gross negligence; that they had not acted reasonably; and that they could therefore not be excused from liability.

The position may therefore be that the Legislature intended the Court's readiness to find that a director or other officer of a company, who has been shown to have been guilty of negligence, nevertheless acted reasonably for the purpose of s 248 for the purpose of s 248. In a case of culpa levissima, reasonableness may be found should vary inversely to the degree of negligence proved: the less serious the departure from the standard of the reasonable man, the greater the readiness of the Court to find reasonableness relatively easily; in a case of culpa levis less easily; and in a case of culpa lata or gross negligence (such as in Niagara Ltd (supra)) reasonableness may virtually never be found."
(Emphasis supplied)

30. However, on these facts, even on that approach, there is no room to contemplate such a prospect. The high point of Carlsson's case is that he operated within the slack practises of the plaintiff. This argument is blind to the inescapable implication that it was unreasonable not to protect the plaintiff from risk, at that time, given the volatile and declining market. It draws mistaken inspiration from a dictum in the judgment of Buckley J in *Re Duomatic [1969] 1 All ER 161 (Chd) at 170 C-D*. In that matter the issue was the culpability of the director drawing money in anticipation of such payment to him being authorised. Buckley J put the point thus:

" in these circumstances can it be said that a director acts reasonably when he makes drawings on account of remuneration to which he is not presently entitled, but to which he hopes to become entitled as the result of some resolution to be passed in the future? Whether he acts reasonably or not must, it seems to me, to some extent depend on the way in which maters have been handled in the company in the past, and I think that it is difficult to say that Mr Evins did not act

> reasonably in continuing to make his drawings in the same way sort of way in which he had made drawings in the previous year."

31. Plainly, any principle that might be drawn from this dictum relates to criticism of a practice that rests on precedent. The true issue in the criticism of Carlsson's conduct is not the participation in the slack adherence to the rules but a failure to stop it when the plaintiff was endangered. (See also: *PNC Telecom plc v Thomas & Others [2008] 2 BCLC 95 (Chd)*, esp paras 86, 91-103)

32. It might have been perfectly appropriate for the plaintiff to defer to a bullish investor taking on huge risk, as Foveros plainly did, but then the plaintiff's managing director ought to have insisted that Foveros bore the risk and insisted that it topped up promptly or closed out. Instead, Carlsson exploited his role as managing director to stall that risk for Foveros and transfer the risk to the plaintiff. Such a barefaced preference of his own interests in a classic conflict of interest situation, was unarguably wrong.

Is there proof of damages suffered?

33. It was argued that despite the accuracy of the account reflecting the trading history of Foveros and the amount outstanding owed by Foveros to the plaintiff there was no proof that the plaintiff had actually paid that sum to the clearing member, the bank.

34. The evidence of Saaiman about the mechanics of payments as between a broker and the bank in terms of the SAFEX rules was that, on a daily basis, the appropriate accounts would be debited or credited as the values of the positions fluctuated. The failure to do so would result in the clearing member closing out positions or buying them itself. Saaiman's unrebutted evidence is that money changed hands one way or another, daily, in

bulk for the entire clientele, including Foveros. In the nature of such arrangements, the reliability of that evidence is corroborated by the continued existence of the open positions on Foveros' account.

35. The contention that the best evidence of payment was not adduced is inappropriate. It can safely be inferred that the sum of the claim was paid to the bank in dribs and drabs over the duration of the account being active.

Conclusions

36. In the result it is held that:

36.1. Carlsson breached his fiduciary duty towards the plaintiff in that he had the duty and the opportunity to protect the plaintiff from risk but preferred his own position as investor to his role as managing director, thereby falling foul of a conflict of interest.

36.2. The fact that the plaintiff's rules and practises to manage and avoid the risk of exposure to an investor client not making good the variation margins on time were not strictly applied could not license Carlsson to exploit that laxity to the detriment of the plaintiff, and such defence betrays by confused perspective by Carlson who, seemingly, did not divorce his investor persona from his director persona.

36.3. *Section 244 of the companies Act 61 of 1973* cannot be invoked to excuse a breach of fiduciary duty that arises from a conflict of interest in which the director

prefers his own interest and subordinates his fiduciary duty to that of his personal interest.

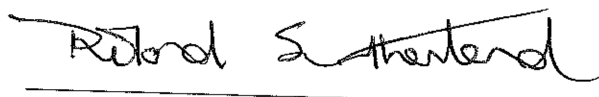
36.4. Adequate proof of payment by the plaintiff to the clearing member was adduced to demonstrate a genuine loss to the plaintiff in the sum claimed.

36.5. As to costs, the employment of two counsel by the plaintiff was appropriate, given the issues pleaded. The failure of Carlsson to testify, which meant that a cross examination could not be conducted into his explanation, if any, and which decision obviously shortened the duration of the trial and the potential aspects that might have been traversed does not diminish the appropriateness of engaging two counsel.

The Order

37. The Second Defendant shall pay to the Plaintiff the sum of R1,233,676.26 together with interest *a tempora mora* at the rate prescribed from time to time from date of judgment until date of payment.

38. Costs of suit, including the costs of two counsel.



ROLAND SUTHERLAND
Judge
Hearing: 10 -11 October 2013
Judgment: 19 November 2013

For the Plaintiff:
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