Reportable

IN THE HIGH COURT OF SOUTH AFRICA
(CAPE OF GOOD HOPE PROVINCIAL DIVISION)

Case No 5516/05

In the matter between:

CHARLES MANNING THATCHER	First Appellant
MICHAEL NEIL McCABE	Second Appellant

and

SIMON KATZ	First Respondent
SAMUEL KATZ	Second Respondent

JUDGMENT: DELIVERED 9 FEBRUARY 2006

GRIESEL J:

Introduction

1]During February 2002, the respondents in this appeal (*plaintiffs*), Mr Simon Katz (*Katz Snr*) and his son, Mr Samuel Katz (*Katz Jnr*), invested amounts of R500 000 and R300 000 respectively in a pyramid scheme conducted by one Ms Amanda Martinson (*Martinson*) in Klerksdorp. They did so through the intercession of the *XYZ Syndicate*, which was co-managed by the appellants, Messrs Charles Thatcher (*Thatcher*) and Michael McCabe (*McCabe*)

(*defendants*). A short while later, the scheme imploded – as all similar schemes inevitably do, sooner or later. Faced with the uncertain prospect of a meagre dividend from Martinson's insolvent estate, the plaintiffs sought to hold the defendants liable for their losses.

2]The plaintiffs' claims were based on a variety of alternative causes of action, both delictual and contractual. The claims in delict were based upon intentional misrepresentation and non-disclosure; alternatively negligent misrepresentation. The claim in contract was advanced on the basis of a breach by the defendants of their contractual obligations, *inter alia* to have taken 'all prudent measures…to reduce the risk to an acceptable level for all the members of the syndicate'.

3]The trial judge (Bozalek J) held in favour of the plaintiffs on the basis of negligent misrepresentation. He accordingly granted judgment in their favour in the amounts of R453 746,87 and R281 248,12[1] respectively, together with *mora* interest and costs. With leave of the trial judge, the defendants now appeal against the whole of the aforesaid judgment.

1 The reason for reducing the *quantum* of the claims was so as to take account of the contingency of a dividend accruing to the plaintiffs from Martinson's estate.

Factual Background

4]It appears from the evidence that the defendants were two of the early investors in Martinson's scheme. They initially invested with Martinson through an investment syndicate operated by one Mr Coetzee, a Potchefstroom attorney. They both enjoyed handsome returns of some 10% per month on their investments and in late 2000 they decided, with the consent of Martinson, to form their own syndicate, the abovementioned XYZ Syndicate, in Cape Town.

5]The XYZ Syndicate grew substantially, both in respect of the number of its members and the extent of its investments with Martinson. By the time the plaintiffs made their investments on 8 February 2002, there were some 32 members with total investments exceeding R18 million.

6]The plaintiffs came to hear about the scheme from an acquaintance. They contacted Thatcher, who paid them a visit at their Bishopscourt home during July 2001 and explained the basis and the operation of the scheme to them as follows: Investors would lend money to Martinson, who would allegedly utilise such funds in order to finance a micro-lending scheme that was operated through a 'registered money-lending company', variously known as ABC Financial Services Pty (Ltd) or ABC Cash Plus and Financial Services Pty (Ltd). The investments were used to make small loans to mineworkers

employed by Anglo-American Mines in the Potchefstroom / Klerksdorp area. These loans were for a period of 30 days and did not exceed R1 500 per borrower. Repayment of the loans was administered by mine management and effected by means of deductions from the borrowers' monthly remuneration. Thatcher and McCabe travelled to Klerksdorp on a monthly basis to deal with Martinson and to collect money owing to the XYZ Syndicate. The lending operation, according to Thatcher, was legitimate and lawful.

7]Attracted by what they had heard, the plaintiffs, on 8 February 2002, invested R500 000 and R300 000 respectively in the scheme through the XYZ Syndicate, represented by the defendants. A short while later, the scheme began to collapse. Apart from one interest payment of R30 000 made to Katz Snr, neither plaintiff ever saw his investment again.

8]By July 2002, Martinson's estate had been sequestrated and two companies which she controlled had been liquidated. An inquiry in terms of s 417 of the Companies Act, 61 of 1973, revealed chaotic and grossly incomplete financial records. It also emerged, to the dismay of investors in the scheme, that Martinson's company was not a registered money lending company. Moreover, no loans had ever been made to mineworkers. In fact, no evidence

of any income-generating activities by Martinson or any of her companies could be found. Her 'business', it transpired, was nothing but a massive pyramid scheme, with Martinson merely 'recycling' the monies invested with her back to some investors at lavish rates of interest. The liquidators anticipated claims of R157 million being filed by investors against Martinson's estate.

9]It is thus apparent that most of the key representations made to the plaintiffs by Thatcher were false. The essence of the defences raised by the defendants to the plaintiffs' claims was an admission of certain of the representations, coupled with the allegation that plaintiffs were made aware at all times that the information contained in the representations was forthcoming from Martinson and that Thatcher believed in the truth thereof. Any negligence on the part of the defendants was denied and it was further denied that either plaintiff suffered any damages as a result of any act or omission by the defendants.

***The Judgment* a quo**

10]In a full and comprehensive judgment, Bozalek J analysed the evidence and made favourable credibility findings in favour of Katz Jnr, preferring his evidence to that of the defendants. In the absence of misdirection on fact by the trial judge, the presumption is that his conclusion in this regard is correct.

An appellate court will only reverse such a conclusion where it is convinced that it is wrong.[2] In the present case, the credibility findings are well-motivated and amply supported by the evidence on record. Bearing in mind this strict test, I have not been persuaded that there are any grounds for interference on appeal with the credibility findings of the trial judge.

11]As to the question of liability, the trial judge found (a) that the plaintiffs had failed to establish their cause of action based on intentional or fraudulent misrepresentation;[3] (b) that they had succeeded, however, in establishing the requisites for a claim based on negligent misrepresentation;[4] and, hence, (c) that it was not necessary to consider the claim based on contract.[5]

12]With regard to the requirements for liability for negligent misrepresentation, the trial judge followed the approach laid down by the Appellate Division in *Bayer SA (Pty) Ltd v Frost,*[6] where it was authoritatively held that there could, in principle, be an action for damages for negligent misrepresentation which had induced a party to enter into a contract.

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2 See eg *R v Dhlumayo* 1948 (2) SA 677 (A) at 706 §8.

3 Record pp 1813–1814.

4 Record pp 1815–1825.

5 Record p 1830.

6 1991 (4) SA 559 (A).

13]The trial judge thereupon embarked upon a detailed analysis of the various requirements for delictual liability in this context and concluded that the plaintiffs had succeeded in establishing all those requirements. On appeal before us, each of those findings of the trial judge was assailed on behalf of the defendants. In particular, counsel for the defendants argued that the plaintiffs had failed to establish the element of unlawfulness as there was no legal duty resting on the defendants.

14]The question of delictual liability in a contractual setting has long been a vexed issue in our law, especially insofar as the element of wrongfulness is concerned.[7] In the leading case of *Lillicrap, Wassenaar & Partners v Pilkington Brothers (Pty) Ltd*,[8] the Appellate Division opted for a 'cautious approach' with regard to an extension of Aquilian liability for pure economic loss in a contractual context. Grosskopf AJA, writing for the majority, held that there was no need to extend Aquilian liability in the light of the fact that, while the contract between them persisted, each party had adequate and satisfactory remedies if the other were to have breached such contract. He continued:

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7 Cf eg Annél van Aswegen *The concurrence of contractual and delictual liability for damages: factors determining solutions* 1997 *Acta Juridica* 75 *et seq*; Dale Hutchison & Belinda van Heerden *The tort/contract divide seen from the South African perspective* 1997 *Acta Juridica* 97 *et seq*; Anton Fagan *Rethinking wrongfulness in the law of delict* 122 (2005) *SALJ* 90 *et seq.*

8 1985 (1) SA 475 (A) at 500F–501B and 501E–G.

> *'Moreover, the Aquilian action does not fit comfortably in a contractual setting like the present. When parties enter into such a contract, they normally regulate those features which they consider important for the purpose of the relationship which they are creating.*
>
> *…Apart from defining the parties' respective duties (including the standard of performance required,) a contract may regulate other aspects of the relationship between the parties. Thus, for instance, it may limit or extend liability, impose penalties or grant indemnities, provide special methods of settling disputes (eg by arbitration) etc. A Court should therefore in my view be loath to extend the law of delict into this area and thereby eliminate provisions which the parties considered necessary or desirable for their own protection. The possible counter to this argument, viz that the parties are in general entitled to couch their contract in such terms that delictual liability is also excluded or qualified, does not in my view carry conviction. Contracts are for the most part concluded by businessmen. Why should the law of delict introduce an unwanted liability which, unless excluded, could provide a trap for the unwary?'*

15]The same 'cautious approach' to the extension of Aquilian liability in a contractual setting was re-asserted in the recent decision of the Supreme Court of Appeal in *Trustees for the time being of Two Oceans Aquarium Trust v*

Kantey & Templer (Pty) Limited,[9] where Brand JA held, with reference to *Lillicrap's* case, *supra*:

> *'The point underlying the decision in* Lillicrap *was that the existence of a contractual relationship enables the parties to regulate their relationship themselves, including provisions as to their respective remedies. There is thus no policy imperative for the law to superimpose a further remedy.'*

16]In the *Bayer* case, *supra,* on which the trial judge placed particular reliance, Corbett CJ articulated the policy considerations for granting delictual relief to a contracting party based on a negligent misstatement as follows:[10]

> *'In my opinion, the law should provide adequate protection for persons induced to contract by a negligent misstatement emanating from the other contracting party and not incorporated as a term of the contract; and in many instances this can only be done by granting the party concerned compensation for consequential loss suffered as a result of the misstatement.'* (my emphasis)

17]It follows *a fortiori*, in my opinion, that where a misstatement has been made, which misstatement *has been* incorporated as a term of the contract, no

9 SCA Case No 545/04, 25 November 2005, para 18 (not yet reported).

10 At 569F–G.

need for a delictual remedy exists.

18]In the present case I am of the view – for reasons which will emerge presently – that, in accordance with the notion of party autonomy, the specific provisions in the contract entered into between the parties should take precedence over the more general duties owed in delict. This implies that the scope of a delictual duty of care in this context should not be more extensive than that provided for under the relevant contract.[11] One could go further and add that the Constitution requires the court to follow this approach: as Cameron JA explained in *Brisley v Drotsky*,[12] the Constitution prizes dignity and autonomy and, in appropriate circumstances, these standards find expression in the liberty to regulate one's life by freely engaged contractual arrangements.[13]

11 Cf Hutchison & Van Heerden *op cit* at 110–1; 112.

12 2002 (4) SA 1 (SCA) para 94.

13 See also *Napier v Barkhuizen* (SCA Case No 569/04, 30 November 2005, paras 12 and 13 (not yet reported)).

Contractual Claim

19]Having regard to the provisions of the agreement in question, I am satisfied that the plaintiffs have an adequate remedy based on their contract. I accordingly find it unnecessary to come to any definite finding with regard to the question whether or not the trial judge was correct in finding for the plaintiffs on the basis of delictual liability.

20]Pursuant to the meeting between the plaintiffs and Thatcher in February 2002, each of them signed a 'lending agreement' with the XYZ Syndicate, recording the conditions governing the loan as follows:

'1. The mechanics of the portfolio into which the funds are lent have been described to the lender in which emphasis was placed on the high risk of the portfolio.

2. The management of the syndicate does not act in a fiduciary capacity but as co-investors who will to the best of their ability keep the investor informed of the progress of his loan.

3. *The management of the syndicate has made no implied or express warranties due to the high risk of the portfolio except to state that they themselves have considerable capital invested in the portfolio and therefore run the same risks as the syndicate. The lender has been informed that all prudent measures have been taken by the operators of the portfolio to reduce the risk to an acceptable level for all the members of*

the syndicate. (my emphasis)

4. *The interest rate applicable to the loan is at present 6% per month. The loan is made for a period of 12 (Twelve) months. The lender has the option of withdrawing the interest monthly or reinvesting it. In the latter event the reinvestment will be for the remainder of the term of the initial loan.*

5. *There are no financial or other guarantees backing the loans made by the members of the syndicate.*

6. *The interest may be reduced as a result of statutory requirements relating to the portfolio.*

7. *Should a member of the syndicate wish to redeem the loan after the initial 12-month period or any time thereafter, a 60-day notice period is required.*

8. *The lender is required to attend to his/her own tax liabilities pertaining to this loan.*

9. *It is a requirement of the syndicate that each lender remains discreet regarding the investment activities of the syndicate, due to the pressure being applied by various banking institutions to enter into the same field of lending.*

10. *The management of the syndicate state categorically that all lending activities are completely legitimate*. (again my emphasis)

11. *All interest withdrawals will be made as soon as possible after*

month-end.'

21]Notwithstanding the disclaimers and disavowal of liability expressed in the agreement, the two clauses that I have underlined contain express warranties on which the plaintiffs, in my view, are entitled to rely. The fact that the warranty in clause 3 purports to be given on behalf of the 'operators of the portfolio', in contrast with the 'management of the syndicate' in clause 10, does not assist the defendants: even if it were to be accepted, for purposes of argument, that the 'operators of the portfolio' are different from the 'management of the syndicate', the plaintiffs have established on a clear balance of probabilities that the warranty was breached. As a fact, no prudent measures had been taken to reduce the risk to an acceptable level for the members of the syndicate – neither by the defendants nor by Martinson and her cohorts, who 'operated' the portfolio. From the defendants' side, the position was aptly summed up by Thatcher, who candidly admitted in his evidence that, with hindsight, they 'should have done many things' to ensure that the lending operation was what it purported to be and that the risk was reduced to an acceptable level. He did not offer any explanations 'for any stupidity I was involved in', adding that Martinson had established her *bona fides* and they trusted her: 'With hindsight now, we look silly. But at that stage we trusted her.'[14]

14 Record pp 860–861.

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22]With regard to the warranty contained in clause 10, no attempt was made – either at the trial or on appeal – to establish the legitimacy of the lending activities; on the contrary, it was common cause at the trial that Martinson's scheme was 'now obviously known to be a fraud'.[15] There was some debate during argument before us (albeit somewhat tentative) as to the question whether the plaintiffs are entitled, on appeal, to rely on the warranty contained in clause 10 in view of the fact that it was not expressly pleaded in the particulars of claim *qua* warranty. In my view, such omission does not preclude reliance thereon at this stage: first, the content of the warranty was adequately pleaded as one of the representations made by Thatcher during his negotiations with the plaintiffs.[16] Secondly, counsel for the defendants were unable to indicate how their defence or conduct of the trial would have differed, had clause 10 in fact been pleaded as a warranty. (This is hardly surprising in view of the concessions referred to above.)

23]In these circumstances, I am satisfied that there has been full investigation of this matter at the trial and there is no reasonable ground for thinking that any further examination of the facts might lead to a different conclusion on this issue. In my considered opinion, the plaintiffs are accordingly entitled to

15 Record pp 1000–1001.

16 Particulars of claim, para 6.14: 'The investment was perfectly legitimate, lawful and did not fall foul of legislation concerning usury.'

rely on both warranties.[17]

24]Having come to this conclusion, it is clear beyond any doubt, based on the evidence accepted by the trial judge, that both those warranties have been breached.

Second Defendant's Liability

25]As a final fall-back position, there was some debate as to McCabe's liability. This was advanced on the basis that McCabe had no dealings, directly or indirectly, with the plaintiffs until mid-2002, by which stage their monies had already been invested and lost. This argument may be disposed of very briefly.

26]In regard to the relationship between the defendants, the evidence was that they worked together as joint managers of the XYZ Syndicate. At their first meeting with Thatcher, the plaintiffs were informed that the Syndicate was controlled and administered by the defendants jointly. Both of them approached potential investors to solicit funds and either one of them would sign the standard contract agreement between the Syndicate and the investor. Who happened to deal with a particular investor, who would travel to Klerksdorp and who would sign whatever document needed to be signed by

17 Cf *Middleton v Carr* 1949 (2) SA 374 (A) at 385–6. See also Herbstein & Van Winsen *The Civil Practice of the Supreme Court of South Africa* 4th ed (1997) 525 and authorities referred to therein.

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the management of the Syndicate was dictated by convenience. The defendants also testified that they split the monthly 'administration fee' of R20 000 equally between them.

27]Furthermore, in his evidence, McCabe did not repudiate any of the representations made by Thatcher to the plaintiffs; on the contrary, his account of the workings of the Syndicate corresponded, in broad outline, with that given by Thatcher. Both defendants were also represented by the same legal team at the trial and relied on the same defences.

28]The trial judge held McCabe liable on the principles of vicarious liability on the basis of their '*de facto* partnership' and as joint wrongdoers. These findings were criticised during argument before us on behalf of McCabe. In view of my finding that it is not necessary to rely on delictual liability, these arguments become irrelevant. Having found that the plaintiffs are entitled to rely on the provisions of their contract with the Syndicate, it is clear that the defendants were joint parties to such contract. This much was made clear by McCabe in his own evidence, where he explained that the agreement was drafted by Thatcher on behalf of *both* of them, because neither of them wanted to accept responsibility for the money of other investors in the Syndicate.[18] It

18 Cf eg Record pp 497, 578–580, 584.

is clear, therefore, that it was the intention that both defendants would be parties to the agreements concluded with investors and that both could invoke the provisions of the agreement for their own protection. It follows, as night follows day, that *both* of them must also jointly accept such liability as may flow from the agreement.

Conclusion

29]For the reasons set out above, I am of the view that there is no merit in the appeal. In the result, I would dismiss the appeal with costs.

B M GRIESEL
Judge

HLOPHE JP: I agree. It is so ordered.

J M HLOPHE
Judge President

2]*18*

3]*PAGE*

ALLIE **J:** I agree.

R ALLIE
Judge