C of A (CIV) 1/2009

IN THE COURT OF APPEAL OF LESOTHO

In the matter between

THE CENTRAL BANK OF LESOTHO	Appellant
and	
MILLENIUM GOAL SOCIETY	First Respondent
MOTA NKUOATSANA	Second Respondent
SETH MOKOTOANE	Third Respondent
THABISO MOLAPO	Fourth Respondent
TIEHO MAFOSO	Fifth Respondent
MOFANA RAMOFANA	Sixth Respondent

CORAM: GROSSKOPF, JA
SCOTT, JA
HOWIE, AJA

Heard 24 March 2009

Delivered 9 April 2009

Summary

First respondent conducting the business of banking as defined in section 2 of the Financial Institutions Act without a licence – its operation constituting a pyramid or money multiplication scheme – High Court making order giving directions for disposal of first respondent's money and property – appeal against certain of the terms of that order - appeal upheld and order amended accordingly.

Judgment

SCOTT JA

[1] The appellant is the Central Bank of Lesotho. The first respondent is the Millenium Goal Society, a society registered in Lesotho in terms of the provisions of the Societies Act 20 of 1966. I shall refer to it as 'the Society'. The second to the sixth respondents are its office bearers. The remaining respondents are various interested parties.

[2] Section 2 of the Financial Institutions Act 6 of 1999 ('The Act') defines 'Commissioner' for the purposes of the Act as meaning the Central Bank of Lesotho. Section 4 (1) of the Act provides that no banking or credit business shall be transacted either in Lesotho or abroad by a local financial institution or in Lesotho by a foreign financial institution unless that institution has been licensed by the Commissioner. The object of the section is to ensure that any such institution complies with various requirements aimed at protecting the public. A 'financial institution' is defined as an institution 'which performs banking business or credit business.'

[3] 'Banking business', in turn, is defined as meaning 'the business of receiving funds from the public through the acceptance of money deposits payable upon demand or after a fixed period or after notice…; and the use of such funds either in whole or in part for loans, investments or any other operation authorized either by law or by customary banking practices, for the account and at the risk of the person doing such business.'

[4] In terms of section 19 (1) of the Act the Commissioner is afforded wide powers to call for the examination of the books, accounts and records of any person which it has reason to believe is engaging in banking or credit business without a valid licence. Of particular importance for the purposes of this appeal is section 19 (2). It provides that where a person transacts banking or credit business without being licensed and holds money or other property by transacting such business, 'the Commissioner may make application to the Court for directions in respect of the disposal of such moneys or property' and the court 'shall give such directions as will, as far as possible, ensure the speedy and efficient return of such moneys or property to the depositor or owner thereof, and may, without prejudice to the generality of the foregoing, direct that such moneys or property be transferred to the custody of the Commissioner for the distribution of the depositors or owners concerned.'

[5] In the course of 2007 the appellant made certain preliminary investigations into the affairs of the Society and as a result on 27

November 2007 sought and obtained ex parte a rule nisi and certain interim orders in the High Court authorizing the appellant to conduct an investigation as contemplated in section 19 (1) of the Act. More particularly, the order authorized the appellant to investigate the affairs of the Society to establish inter alia the amount of money obtained by it in contravention of the provisions of the Act, the identities of all persons from whom money was obtained and the whereabouts of the money so obtained. To this end the appellant was authorized to take various steps including the employment of the services of PricewaterhouseCoopers, the Deputy Sheriff and where necessary the assistance of the Lesotho Police Force. In addition, the Society and the second to the sixth respondents were interdicted from receiving or paying money to members of the public. The appellant, in turn, was directed to report to the court within 90 days of the order or within such extended period as the court might allow 'regarding the investigation and its recommendations as to the disposal of money or property referred to in the report.'

[6] Following the issue of the rule nisi, Mr Trevor White, a forensic auditor in the employ of PricewaterhouseCoopers submitted various reports concerning the affairs of the Society. From these, the affidavits filed and the viva voce evidence of both White and the second respondent, Mr Nkuoatsana, it became quite clear that the Society was conducting a banking business as defined in section 2 of the Act without the necessary licence. It conducted this business from a number of branches in Lesotho where it received money from the public, i.e. anyone over the age of 21 years, by way of investments for

a fixed period and with a guaranteed return. The money so received was invested purportedly to generate the returns it was obliged to pay the investors.

[7] It is important to observe, however, that the operation was nothing more than a so-called 'pyramid' or 'money multiplication' scheme which was unsustainable and would collapse once the investments made ceased to increase at a rate sufficient to maintain it. Members of the public were invited to join the scheme by paying what in effect was a nominal administration fee of M22 and then to invest money with the Society. They were afforded three options. The first, which was advertised as 'Option A', was an investment of M650 for a fixed period of one year at the end of which the investor would be paid M1500. This represented a return of 131 per cent per annum. Option B provided for the investments to be made on a monthly basis. The return promised under this option was even greater than 131 per cent per annum. Option C was similar to option A, i.e with the same percentage return, but the investment period was longer. The Society's advertised objective was 'to alleviate poverty' among its members. The scheme was calculated to achieve the very opposite. The initial investors were paid their promised returns. In all, some M2.4 million was paid out. Their success, and no doubt the noble sounding objective of the scheme, enticed others to invest their meagre resources. The money flowed in at what White described as 'an astronomical rate'. For much of the time the money remained deposited in an account at the Standard Lesotho Bank earning interest at less than 9 per cent per annum – a far cry from 131 per cent. The

payouts were without doubt financed by the incoming investments. On 31 October 2007 the Society purchased 5 shares at M500 000 each (a total of M2.5 million) in a motor vehicle tracking company called EWC Vehicle Communication (Pty) Ltd. On 22 November 2007 it purchased unit trusts in Stanlib Managed Flexible Fund to the value of M5 million. There was no possibility of the Society's investments generating the returns it had promised its investors. The collapse of the scheme was inevitable and Nkuoatsana's protest in the course of his evidence that it failed only because of the appellant's intervention was either dishonest or founded upon an incomprehensible naivety.

[8] By December 2008 the assets of the Society amounted approximately to M7 784 737, made up as follows:-

Stanlib Managed Flexible Fund (as at 26 September 2008)	M4 609 571
Shares in EWC Vehicle Communication (Pty) Ltd (as at 26 September 2008)	M3 000 000
Cash held by the Society	M 85 535
Standard Lesotho Bank	M 89 631
	M7 784 737

(To this must be added the interest accruing from the cash deposits.)

[9] The evidence disclosed that the Stanlib investment had declined in value while the value of the EWC shares – according to the chief executive officer of the company – had increased from M500 000 to M600 000 per share. The figure of M7 784 737, as I have said, is an approximate figure and in the nature of things is not constant.

[10] White's forensic investigation revealed that there were 4463 unpaid investments which had been made by a total of 3832 investors. To repay the unpaid investors merely what they had invested without any return on their money would require M16 417 117. For this, there was a shortfall of over M8 million. A return of 131 per cent on that amount (being the minimum per annum promised) would require a total amount of M37 653 270.

[11] On 30 October 2008 Peete J confirmed the rule nisi granted on 27 November 2007 and in addition granted an order declaring the business conducted by the Society to be banking business within the meaning of the Act. On 10 December 2008 the learned Judge handed down reasons for his order and on the same day made an order giving directions in terms of section 19 (2) of the Act (referred to in paragraph 4 above) for the disposal of the moneys received in the course of the Society's banking business. The present appeal is directed solely against the latter order. The respondents did not oppose the appeal.

[12] It is necessary to quote the material part of the order made in terms of section 19 (2) in full:-

"1. (a) The 1st respondent is directed to sell its shares in EWC Vehicle Communication (Pty) Ltd to an outsider buyer who is a highest bidder by the 10th March 2009.

(b) *The sale agreement shall be in writing and proceeds of the sale shall be held by Central Bank of Lesotho (CBL) in*

a special trust at the Standard Lesotho Bank.

(c) By the 10th March 2009, the 1st to 6th respondents are authorized and directed immediately to transfer the unit trusts presently held by 1st respondent in the Stanlib Managed Flexible Fund under Account No. 551251708 without any withdrawal into a Money Market Fund.

(d) The Standard Lesotho Bank Unit Trust is ordered to facilitate this transfer forthwith.

(e) The interest accrued must be transferred every thirty days into the special trust account aforementioned.

(f) Any shares remaining unsold by the 10th March 2009, shall thereafter be sold within 30 days by the applicant and proceeds thereof to be deposited at the aforesaid trust account in Standard Lesotho Bank.

(g) The following cash which will be readily available [will] be the first one to be distributed to the investors-

(i) The M85 535.20 which is presently being held by the Central Bank of Lesotho;

(ii) *The M89 631.95 which belongs to the First Respondent and is currently kept in its account No.0140037306301 at the Standard Lesotho Bank;*

(iii) The M46,761 which accrues to the First Respondent from the Money fund every 30 days;

2. Distribution of all payouts to be handled by the Central Bank of Lesotho and to be effected on a "first in time first payout" basis to all depositors.

3. Counsel of applicant and of 1st to 6th respondents must present a full and written Report to the Court on the 10th March 2009 for consideration and/or further directions."

[13] The appellant's criticism of the order was confined to paragraphs 1 (a), 1(g) and 2. I shall deal with each in turn.

[14] As to paragraph 1(a), counsel for the appellant raised three objections. The first was that there was no good reason why the purchasers of the EWC shares should be limited to 'an outside buyer'. The second was that the price at which the shares were to be sold ought to have been made subject to the approval of the appellant or the Court. The third was that the reference to the EWC shares should have included a reference to the Society's loan account in the company. In my view all three objections are well made.

[15] The most likely purchasers of the shares would be the other shareholders. I can see no reason why they should have been

excluded as potential purchasers, nor was any reason advanced in the judgment. Indeed, the Society could find itself hard pressed to find an outside buyer for shares in a private company. The limitation accordingly has no rational basis and in my view must be deleted.

[16] As far as the need for approval of the price is concerned, I share the concern of the appellant that in the absence of such a requirement it would be possible for the Society to sell the shares to an associate for less than their market value. The need to preclude such an eventuality, I think, is essential in the circumstances. It should not be overlooked that the Society operated a pyramid scheme, in effect a scam. Its office bearers could hardly have been unaware of the loss the later investors would suffer, but this did not deter them. They should not now be given a free hand to sell the shares without supervision. One can only conclude that the Judge a quo overlooked this very important consideration when granting the order.

[17] Of lesser importance is the need for the order to refer to the Society's shares and loan account in EWC Vehicle Communication (Pty) Ltd. However, as paragraph 1(a) of the order is in any event to be amended, I think it a wise precaution, in the absence of full particulars regarding the shares, to include a reference to a loan account. I accordingly propose to substitute a paragraph 1(a) which will meet the objections raised by counsel.

[18] The appellant's objection to paragraph 1(g) of the order is that it contemplates two payouts, first of the cash referred to in that

paragraph and second, at a later date, of the proceeds of the remaining assets. It will be recalled that there were no fewer than 3832 investors to whom payments had to be made. The evidence revealed, too, that many of the investors did not have bank accounts. The process of effecting payment is therefore likely to be both difficult and expensive. In the circumstances, the requirement that there be two payouts would involve unnecessary expenditure and would be impractical. This, too, appears to have been overlooked by the court a quo.

[19] I turn, finally, to paragraph 2 of the order. It provides for payment to be made to investors on a 'first in time first payout' basis. Counsel submitted that the distribution should be on a pro rata basis. I agree. The primary objection to a pyramid scheme is that the early investors are benefited at the expense of the later investors. Indeed, the former are paid from the deposits of the latter so that the collapse of the scheme is inevitable. In the present case there is a shortfall of more than M8 million merely for the purpose of returning the deposits of the unpaid investors. To distribute the funds available on a 'first in time first payout' basis would be to give effect to the scheme to the extent of benefiting the early investors at the expense of the later investors. In my view this would be untenable. Furthermore, as pointed out by counsel, the court is enjoined in terms of section 19 (2) of the Act to give such directions as will as far as possible ensure the return of moneys deposited to the depositors. There is nothing in the Act to justify some depositors being preferred above others. It follows that the order must be amended to provide for the distribution

to be effected on a pro rata basis.

[20] Counsel for the appellant did not ask for the costs of appeal and no order as to costs will be made. Where the order of the court a quo refers to 10 March 2009, by which date various things had to be done, I propose to substitute 9 May 2009.

[21] In the result the following order is made:-

(A) The appeal is upheld

(B) The order of the court a quo made in terms of section 19 (2) of the Financial Institutions Act 1999 is amended so as to read as follows:

'(1)(a)The first respondent is directed to sell its shares and loan account in EWC Vehicle Communication (Pty) Ltd at a price approved by the applicant or by this Court, by 9 May 2009.

(b) *The sale agreement shall be in writing and the proceeds of the sale shall be paid to and held by the Central Bank of Lesotho in a special trust account at the Standard Lesotho Bank.*

(c)By 9 May 2009 the first to sixth respondents are authorized and directed to transfer the unit trusts presently held by the first respondent in the Stanlib Managed Flexible Fund under account number 551251708 without any withdrawal into

a Money Market Fund.

(d)The Standard Lesotho Bank Unit Trust is ordered to facilitate this transfer forthwith.

(e)The interest accrued must be transferred every thirty days into the special trust account aforementioned.

(f) Any shares remaining unsold by 9 May 2009 shall thereafter be sold within 30 days by the applicant and the proceeds thereof deposited at the aforementioned account in the Standard Lesotho Bank.

(g)The appellant is authorized and directed to distribute the following funds on a pro rata basis to the investors referred to in paragraph 11.002 of the report by PricewaterhouseCoopers dated 26 September 2008;

(i) *The sum of M85 535.20 which is presently held by the Central Bank of Lesotho;*

(ii) *The sum of M89 631.95 which stands to the credit of the first respondent in account number 0140037306301 with the Standard Lesotho Bank, together with such interest as may have accrued thereon;*

(iii) *The proceeds of the unit trusts referred to in*

paragraph 1 (c) above, together with the interest accrued thereon;

(iv) The proceeds of the sale of the said shares and loan account in EWC Vehicle Communication (Pty) Ltd.

(2) Counsel for the applicant and for first to sixth respondents are to present a full written report to the court on 9 May 2009 for consideration or further directions.'

D. G. SCOTT
Justice of Appeal

I agree

F. H. GROSSKOPF
Justice of Appeal

I agree

C. T. HOWIE
Acting Justice of Appeal

For the Appellant	Adv. J.A. Ploos Van Amstel SC
For the Respondents	No appearance