IN THE COURT OF APPEAL OF LESOTHO

C of A (CIV) N0.12/08

HELD AT MASERU

In the matter between:

STARLION GROUP (PTY) LTD
& OTHERS **APPELLANTS**

and

CENTRAL BANK OF LESOTHO **RESPONDENT**

CORAM:

GROSSKOPF, JA
SCOTT, JA
HOWIE, AJA

Heard : 24 March 2009

Delivered : 9 April 2009

SUMMARY

Financial Institutions Act, 6 of 1999 - Insurance Act, 18 of 1976 -respondents obtaining money from the public by operating various schemes offering funeral or insurance or investment benefits - the operation involving pyramid schemes - Central Bank granted a rule nisi aimed at investigation and cessation of the schemes – the rule requiring cause to be shown, inter alia, why the schemes should not be declared "banking business' or 'insurance business' carried on in conflict with one or other of

the two statutes - rule confirmed - appellants objecting only to the declarators - appeal dismissed.

JUDGMENT

HOWIE AJA

[1] This is an appeal against the confirmation, in all respects, of a rule nisi obtained by the Central Bank of Lesotho (the Bank) against the eight appellants. (The other respondents in the court below have not appealed.)

[2] In terms of the Central Bank of Lesotho Act, 2 of 2000 the Bank's functions include the licensing of institutions pursuant to the Financial Institutions Act, 6 of 1999 (the FIA) and the Insurance Act, 18 of 1976, and the promotion and monitoring of a sound and stable national financial system. For the performance of its functions under the latter two statutes the Bank is assigned the offices of Commissioner and Commissioner of Insurance respectively.

[3] The eighth respondent, Mr. S.L. Thebe-ea-Khale has the controlling interest in the first to sixth respondent companies and owns the seventh respondent firm. It is convenient for present purposes to refer to the first seven respondents as 'the group', where appropriate.

[4] In terms of S 2 of the FIA "banking business" means –

'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, or any similar operation through the sale or placement of bonds, certificates, notes or other securities; 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'.

[5] Section 4 (1) of the FIA forbids transaction of banking business without a licence issued by the Commissioner. Section 19 empowers the Commissioner to cause the examination of the records of any person it has reason to believe is carrying on unlicensed banking business and to apply to court for directions to enable the expeditious return to the depositors or owners of money obtained by way of such business.

[6] The Insurance Act defines 'insurance business' as

'the assumption of the obligation of an insurance company in any class of insurance business…'

and an 'insurance company' as 'any person carrying on insurance business'.

[7] Section 3(1) of the Insurance Act forbids the carrying on of insurance business by an insurance company without registration by the Commissioner of Insurance and the issue by the latter of a certificate

of registration. In terms of s 55 (2) the Commissioner is responsible for the enforcement of the Insurance Act.

[8] The importance of registration and enforcement under this Act is illustrated by the financial requirements it lays down. In terms of s 7 (1) minimum amounts are fixed in respect of the paid-up capital which an intending insurer must have before it will be registered. And in the regulations promulgated under the Act in Legal Notice 71 of 1985 it is laid down what financial provision must be made for a reserve to cover unexpected risks; what minimum amount must be invested in respect of working capital; and what assets an insurer must have invested.

[9] None of the appellants is licensed to carry on banking business or registered for the conduct of insurance business under the respective relevant statutes.

[10] The background to the grant of the rule nisi is, briefly, as follows. In its capacity as Commissioner of Insurance the Bank learnt in 2001 that the seventh respondent was offering insurance products that constituted insurance business as defined. The Bank, having drawn attention to the need for statutory compliance in that regard, a company named Star Lion Insurance Company (Pty) Ltd was incorporated. The Bank issued it with a licence for the conduct of insurance business for one year. This was subject to the condition that the company did not operate as an insurer until the Bank was satisfied

that it was adequately funded and was complying with the Insurance Act.

[11] The licence expired and was not renewed. The company nevertheless continued, according to information available to the Bank, to conduct insurance business unlawfully. In an endeavour to ensure that insurance business within the group was lawfully carried on, the Bank required the company to be converted to a public company. This was done, and the second respondent was formed. In addition, in June 2007, an agreement entitled 'Memorandum of Understanding' was entered into between the Bank and the third respondent. It recorded that the third respondent carried on insurance business and that the object of the agreement was to assist it to regularize its activities in order to qualify for registration. In keeping with that object, provision was made for the parties to give mutual assistance and for the mutual exchange of information for the purposes of the need of each to comply with the law.

[12] To investigate the activities of the third respondent in terms of the agreement (and its relevant products were named) the Bank appointed PricewaterhouseCoopers (PWC), forensic accountants. Their investigation, headed by Mr. T.S. White, began on 25 September 2007. Initially they received co-operation. Subsequently the third respondent's staff, so it is alleged, declined further co-operation. This hampered the investigation which nevertheless unearthed significant information.

[13] In due course, on 16 November 2007 White, for PWC, furnished a report to the Bank on the strength of which it applied for the rule nisi in question. The report, which concerned the activities of the third respondent and other entities in the group, was based on information supplied by group personnel in interviews and the limited documentation, so it was reported, to which the eighth respondent allowed access.

[14] White concluded that the sixth respondent offered a product called the Pension and Equity - Creator and that other entities in the group, which could not then be identified, administered schemes respectively called the Bursary Scheme and the One Million Scheme.

[15] They reported that the One Million Scheme, which started in January 2007, guaranteed an investor M1 million on a monthly investment of M195 for 10 years. The scheme was fully subscribed and monthly premiums were being paid. To meet its obligations under the scheme the group or its relevant entities would need to have M10 billion. The eighth respondent, so it was reported, refused information and documentary access as regards the scheme. PWC calculated that investment of the premiums to realise M10 billion would need to yield an annual return of 55,53%. Not surprisingly, PWC reported that a growth rate of that order was unachievable and that investors would, at best, receive very much less than promised. If the premiums they paid were used to pay out members of other group schemes, then One Million Scheme members might get nothing.

[16] The Pension and Equity-Creator Scheme, it was reported, bore the characteristics of a typical pyramid scheme. It began in May 2007 and within six months had 17 570 members. A pyramid scheme promises returns far greater than commercially obtainable. To pay initial investors the contributions of later investors have to be used. The more membership grows the less the scheme can meet its commitments and it inevitably collapses.

[17] The Bursary Scheme commenced in 2001. It offered, on a lump sum investment for twelve months, a return of 66, 67%.

[18] Membership of each scheme entailed being a member or policyholder in respect of some other group product and there was also a relatively small initial charge payable. Subject to those charges, membership or policyholder status in respect of any group scheme was open to the public without restriction.

[19] White concluded that three schemes to which I have referred constituted banking business in conflict with the FIA, and operation of the One Million Scheme and the Pension and Equity-Creator Scheme constituted insurance business in contravention of the Insurance Act. In the course of its business the group's available record showed that it had received hundreds of millions of Maloti of public money.

[20] White and his staff were unable to determine which entities within the group operated the schemes but were of the view that the products offered were offered by the group as a whole.

[21] The rule nisi was granted on 27 November 2007. The order incorporating the rule stated that all but two of its provisions would have interim effect. The provisions with such effect (sub paragraphs (a) to (h) of paragraph 2) authorized the Bank, with the assistance of PWC, to investigate the affairs of the appellants, to inspect and copy their documents and to examine their employees, all with a view to establishing who had paid money to the group, how much had been paid and where the money (or property acquired with it) was. The appellants were directed to allow and assist such investigation and the Bank was directed to report to the court in writing regarding the investigation and its recommendations with regard to the further conduct of the matter.

[22] The two provisions which did not have interim effect were sub-paragraphs (i) and (j) of paragraph 2. In terms of those provisions appellants and any other interested parties were called on to show cause why it should not be declared that

> '… the business conducted by one or more of the first to the eighth (appellants)…'

by way of the schemes referred to (and any other business identified pursuant to the investigation) constituted banking business as defined (sub-paragraph (i)) or insurance business as defined (sub-paragraph (j)).

[23] Pending the extended return day of the rule White filed a

First Interim Report dated 15 February 2008. Based on the information available to him up to that date he expressed the same conclusions as he had set out in his November report. He went on to state that a total of at least M345 218 700 had been paid to the group in respect of all three schemes mentioned above. However the total indebtedness to investors or policyholders was in excess of M800 million, which was significantly more than the value of the assets that had been identified as the appellants'. In fact, with the exception of a total of M448 509 in bank accounts of various of the appellants, and M41 114 in cash, there were no liquid assets which could be used to pay investors claims. Indeed, the eighth respondent had often told White, so the latter alleged, that the appellants had no cash.

[24] To make matters worse, cheques with a value of M478 800 drawn on bank accounts of two of the appellants had been dishonoured; there were overdue Bursary Scheme claims with a payout value of over M21 million; and unpaid Bursary Scheme claim forms had accumulated, the payout value of which had not yet been determined. White ended this report by stating that the appellants and their employees had done everything to frustrate and delay the investigation process.

[25] The eighth appellant deposed to an affidavit on behalf of all the appellants. He insisted that he and his staff had co-operated with the investigators and asserted that every investor would be paid as promised, indeed, some had already been paid. He stated that the money invested was not for safekeeping at a bank but for investing so

as to generate the funds necessary to pay the promised returns. Significantly, however, he did not reveal where such investments were made or what they were realizing. Referring to the other appellants, he said

> 'All these companies have their own investments and assets that can sustain this business for years'.

His reference to 'this business' when referring to the activities of all the appellants tends to strengthen White's conclusion that the appellants operated as a group, despite the allegation elsewhere in the affidavit that each company has its 'own activities'.

[26] He denied that a pyramid scheme was involved or that any banking business was being conducted. He also denied that the appellants were carrying on unregistered insurance business, contending that the Bank had known for a long time that the third appellant was conducting insurance business and had been instrumental in assisting the furtherance of such business. However, he did not claim that a certificate of registration had ever been issued or that the third appellant was currently registered.

[27] As regards White's calculations as to how much would be required to pay investors, he protested that the appellants needed to engage their own experts to make the necessary computations. He claimed that he and the other appellants learnt for the first time when they received the application papers that what was promised to investors was unrealistic or unsustainable. He went on to explain that the One Million Scheme was a form of 'direct marketing product' where the

investor received a 'certain return … based on the number of people he recruits'. This feature, he said, distinguished the scheme from a pyramid scheme. Tellingly, he said:

> 'From an analysis of Mr. White's affidavit it is clear that he lacks the knowledge and experience in which businesses or operations of this nature are managed. It does not look like he has the capacity to comprehend the systems in place regardless of how often they may be explained to him. Both he and his colleagues seem not to have the basic knowledge of the operations and management of venture investments which is why their computation are premised on market rates since venture investments are not normal business undertakings and by their very nature risky (calculated) they therefore yield high returns. It must be common knowledge that high returns carry with them a certain amount of risk and this is exactly what the investing public fully understand and appreciate hence the reason they have not sought the courts intervention. Without any doubt this form of behaviour on the part of the investing public can be reasonably be inferred as sign of confidence in the operation of Respondents'.

This passage does not serve to show ignorance on White's part as to the implications of the schemes. Rather it highlights the grave extent to which the investors' money was in jeopardy. The deponent obviously has no comprehension of the extent of the true risks or deliberately ignores it.

[28] On 6 June 2008 Guni J granted an order confirming the rule in all respects, holding that the papers clearly established that the appellants were conducting unlawful banking and insurance business.

[29] The thrust of the grounds stated in the notice of appeal is to the effect that the learned Judge a quo erred in confirming the declarator provisions in paragraph 2 (i) and (j) of the rule, seeing that the investigations and report to which the rule referred were yet to come, and more particularly in finding that all the appellants were conducting banking and insurance business when the evidence failed to establish this in the case of any particular appellant.

[30] In this court there were times during the argument of Mr Khauoe, for the appellants, when he veered towards the submission that the entire rule should have been extended until completion of PWC's investigations and report. And at one point he even seemed to venture the contention that the rule should have been discharged. Given the weight of the evidence on record such submissions cannot possibly prevail. It was as well, therefore, that he decided to confine himself to the argument, foreshadowed in the notice of appeal, that the evidence currently failed to identify which appellant or appellants were operating the three schemes referred to above and that no declarator could properly issue until subsequent investigation and report revealed more facts.

[31] I think, however, this argument misses the point. I agree with the submission of Mr. Van Amstel, for the Bank, that the primary purpose

of the application was to halt conduct of the business in the course of which the schemes were operated and not to identify which appellant or appellants were involved in the operation of which scheme. Hence the wording of the declarators. By the time the matter came before Guni J the evidence showed clearly enough, in my view, what the three schemes entailed and that they not only involved pyramid schemes but constituted either unlawful banking business or unlawful insurance business. That being so, there was good reason to interdict their continuation whichever appellants were operating them. No further information or report in that regard was needed. The further investigation and report was therefore obviously aimed at discovering the fate of the investors' money and, as far as possible, effecting its refund.

[32] It follows that there was no purpose in extending that part of the rule nisi incorporating subparagraphs 2 (b) (i) and (j), either for the Bank's purpose in pursuing the application or the appellants' purpose in seeking to resist it.

[33] In confirming the rule in all respects the court below was right. The appeal must therefore fail.

[34] It remains to mention that the record lodged by the appellants omitted White's first interim report. The Bank supplemented the record accordingly. We were informed, without challenge on behalf of the appellants, that this report was available to their legal representatives and the court when the matter was argued before Guni J. Moreover,

the furnishing of the report constituted compliance with the directive embodied in paragraph 2 (g) of the rule, which operated with interim effect, and required the Bank to report to the court below with regard, inter alia, to the further conduct of the matter in the light of its investigation. The additional volume of the record containing White's interim report was therefore necessary for the proper adjudication of the appeal. The costs relative to it are properly costs incurred by the Bank in contesting the appeal.

[35] It is ordered that the appeal is dismissed, with costs.

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CT HOWIE

Acting JUSTICE OF APPEAL

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I agree FH GROSSKOPF

JUSTICE OF APPEAL

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I agree DG SCOTT

JUSTICE OF APPEAL

For the Appellants:	Mr. KT Khauoe
For Respondent:	Adv. JA Ploos van Amstel SC