IN THE APPEAL BOARD OF THE FINANCIAL SERVICES BOARD

CASE FAB 1/2016

In the matter between

ACS FINANCIAL MANAGEMENT CC	First Appellant
CORNELIA SJ SNYMAN	Second Appellant
And	
PAULINA SUSANNA COETZEE	Respondent
And	
THE OMBUD FOR FINANCIAL SERVICES PROVIDERS	As amicus

Appeal panel: LTC Harms (chair), Mr D Brooking and Mr G Madlanga

For the appellants: Mr P Bielderman of Bieldermans Incorporated

For the respondent: Adv N Louw

For the Ombud: Adv D Mpofu SC and Adv SL Shangisa

Hearing: 12 September 2016

Judgment: 19 September 2016

Summary: Determination by FAIS Ombud – procedure – liability of FSP – legal duties – causation.

JUDGMENT

INTRODUCTION

1 This is an appeal by ACS Financial Management CC and Ms Cornelia Snyman, its sole member.[1] Both are authorised financial service providers (FSPs) in terms of the Financial Advisory and Intermediary Services Act 37 of 2002.

2 They appeal against a determination by the Ombud for Financial Services Providers in favour of the respondent, Mrs PS Coetzee, in which her complaint against them was upheld and they were ordered to pay her an amount of R530 000 with interest as from 1 November 2009.

3 The Ombud was invited by the Appeal Board in terms of rule 12(j) to submit and present argument as amicus in view of the general attack by the appellants on her methodology in the papers.[2]

4 The complainant, a retired widow, was advised during 2005 by Snyman, acting as aforesaid, to make an investment in a property syndication of one of the companies in the Bluezone property group. After a while the promised return on the investment began to wither as did the investment itself and this gave rise to a complaint laid with the Ombud during 2010.

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[1] The identity of the first appellant is somewhat of a mystery because it is Multi-Professional Services CC trading as ACS Financial Management CC. How one close corporation can trade as another close corporation is not understood.

[2] Rules on Proceedings of the Office of the Ombud for Financial Services Providers, 2003, BN 81 of 8 August 2003.

5 In her complaint Mrs Coetzee pointed out that since the death of her husband, Snyman had been giving her personal financial advice and that she had allowed Snyman to manage her financial affairs. Snyman recommended that she withdraw funds from a stable Sanlam investment account (which had matured) and invest R530 000 in a Bluezone scheme. She was presented with an income plan promising a monthly income of R4 257.00 for the first year and projected increases indicated until the tenth year. Her concern at the time was whether she should not rather invest in an established institution but the advice from Snyman was that Bluezone provided a fixed return investment.

6 She explained that her relationship with the second appellant had always been one of trust. The pertinent allegation for present purposes is that she was told

> "that the Bluezone investment was guaranteed, without warning me about the risk involved in such an investment, particularly after I questioned whether it would not be more advisable to retain the funds in an established fund."

7 The case manager of the Ombud presented the appellants with the complaint and asked for their response, and also requested additional information. After further correspondence and a statement filed on behalf of the appellants the Ombud made a determination on 30 March 2012, holding the appellants liable for the repayment of the amount invested.

8 This led to an appeal, which was upheld by the Appeal Board on 26 February 2014. In terms of the order the matter was remitted to the Ombud for investigation of certain

aspects which (according to the decision) had not been investigated properly or at all, and for reconsideration of the matter thereafter.

9 According to the Ombud, her office made the investigations required by the Appeal Board and she reconsidered the matter. In the course of this, the Ombud sought additional information from the appellants to which a mainly argumentative response was provided during February 2015.

10 The Ombud in her second determination again upheld the complaint. Dissatisfied, the appellants applied to the Ombud for leave to appeal, which was refused. They then applied to the deputy chair of the Appeal Board for leave which was granted in respect of specific issues only, namely whether:

- the appellants had breached any legal duty in the provision of financial services;
- they were negligent, i.e., whether the advice was culpably bad;
- there was a causal connection (factual or legal) between any breach or negligence and the respondents loss; and
- other (mentioned) issues to the extent that they are relevant to the preceding three issues.

11 For the rest leave was refused. Unfortunately, the subsequent grounds of appeal required by the Regulations and the heads of argument did not follow the directive. The appellants' attorney conceded in the heads that they continue to raise procedural issues contrary to the terms of the leave to appeal. During the hearing the argument was more or less confined to the terms of the leave but since the argument was not abandoned we deal with some aspects.

THE JURISDICTION AND PROCEDURE OF THE OMBUD

12 It is convenient once again to refer to the provisions of section 20(3) and (4) of the Act:

> (3) The objective of the Ombud is to consider and dispose of complaints in a procedurally fair, informal, economical and expeditious manner and by reference to what is equitable in all the circumstances, with due regard to—
>
> *(a)* the contractual arrangement or other legal relationship between the complainant and any other party to the complaint; and
>
> *(b)* the provisions of this Act.
>
> (4) When dealing with complaints in terms of sections 27 and 28 the Ombud is independent and must be impartial.

13 Section 27(5) states that the Ombud may, in investigating or determining an officially received complaint, follow and implement any procedure which she deems appropriate and she may allow any party the right of legal representation.

14 The main (written) argument was that the process followed by the Ombud was unconstitutional and fundamentally flawed and should be set aside on that ground alone.[3] It was thus formulated:

> "The Ombud should be obliged by the FSB to adopt a fair process in terms of section 27 (5) which must include, at least, a charge sheet, statement of claim or similar notification to inform the FSPs is of all factual allegations that sought to be held against them, a hearing where cross-examine may take place and legal representation."

[3] This submission gave rise to the request to the Ombud to take part in the appeal because it goes to the heart of the processes followed or to be followed by her office.

15 First, the Ombud is independent and the FSB cannot oblige her to follow any process. Second, what the appellants in effect submitted was that the Ombud must follow a formal trial procedure irrespective of what is fair, economical, expeditious or equitable in the circumstances of the case. The submission flies in the face of the express wording of the Act. If resolution of a matter requires an investigation of that detail and formality, the Ombud has a discretion in terms of sec 27(3)(c) to decline to entertain the complaint and leave it to the parties to explore other avenues such as litigation.

16 It is always open for an aggrieved party to make out a case that the procedure which in the specific case was followed was procedurally unfair or that it was inequitable in the circumstances of the case and that, as a result, the determination could not be justified on the record. In other words, the procedural fairness is fact specific and there is no general rule which should or could apply in all circumstances.

17 As will become apparent, this matter can be decided with reference to undisputed facts and it is accordingly not necessary to say more about the procedure adopted.

BASIS OF LIABILITY OF AN FSP

18 Another general complaint raised by the appellants is that the Ombud decides cases on "equity" and not on legal principles. The Ombud denies this and there is no reason to doubt that the Ombud sought to apply legal principles. Whether they are correctly applied on the facts of any particular matter is another question and once again depends on the particular facts of the case.

19 The legal liability of an FSP towards a complainant, which is subject to the jurisdiction of the Ombud, may arise from different causes of action. There is, in the first instance, a

possible contractual liability. There is also the possibility of delictual liability. And then there is unjust enrichment.

20 Delictual liability is not limited to liability under the *lex Aquilia* where issues of wrongfulness, negligence and causation arise. A complaint may flow from non-compliance with the provisions of the Act which by definition includes any regulation, rule or code of conduct. Sub-section (3)(b) recognises this. In such a case negligence would not necessarily be an element although causation is required.[4] This is the context of the first issue on which leave was granted, namely whether the appellants had breached any legal duty (statutory or common-law) in the provision of financial services.

NATURE OF THE APPEAL

21 This is a *de novo* appeal and will be dealt with as such.

22 It is necessary to reiterate that the function of the Appeal Board is to decide whether, on the record as it now stands, the second determination of the Ombud was correct. The reasons of the Ombud are not the issue but her conclusion on a fair evaluation of the facts because she may have reached the correct conclusion for wrong reasons.

23 The question is then whether the advice to invest in the Bluezone scheme was "bad" (in the general sense). There is merit in the submission that the Ombud's determination is capable of being read as based on hindsight: because it transpired that Bluezone was a Ponzi scheme or a fraud it has to follow that the advice must have been bad. The

[4] E.g. *Callinicos v Burman* [1963] 1 All SA 580 (A), 1963 (1) SA 489 (A), *Da Silva v Coutinho* [1971] 3 All SA 264 (A), 1971 (3) SA 123 (A), *Simon's Town Municipality v Dews* [1993] 1 All SA 238 (A), 1993 (1) SA 191 (A) 196. The breach need not be the sole cause of the damage, provided it contributed materially thereto: *Da Silva v Coutinho* at 141.

question instead must be answered with reference to the merit of the advice at the time it was given, a matter to which little attention was given by either the Ombud or the parties.

THE AUTHORITY OF APPELLANTS AND BLUEZONE

24 Snyman acted as a section 13 representative of Bluezone. She explained that Bluezone had been both an authorised FSP and product supplier, something she had checked and which was important to both her and the complainant.

25 The Ombud held that the appellants had failed to conduct a due diligence in this regard and said that if they had they would have established that Bluezone, in 2005, was not licenced to market this product and that the appellants were in this regard negligent. A further consequence of her finding would have been that the provision of the particular advice would have been illegal and not only negligent.

26 It is a pity that the Ombud did not attach the necessary documentation to support such a serious allegation. We called during the hearing for the then current authority of Bluezone and it appeared that the Ombud had no basis for her finding. Bluezone was authorised to market "Securities and instruments: Shares".

27 The Ombud thought that the product was "debentures and securitised debt", something not authorised. A glance at the agreement, to which we shall revert, would have revealed that shares and a loan account were sold. There is no reference to debentures or to the securitisation of any debt anywhere on the record.

THE ADVICE

28 As mentioned, the appellants acted as section 13 representatives of Bluezone. Snyman in her capacity as controlling member of ACS advised the respondent to invest in a Bluezone company. The respondent accepted the advice.

29 Snyman knew that the respondent had limited funds and that she was dependent on those funds. She knew that the respondent was averse to risk taking. She required a fixed income and some growth.[5]

30 As also mentioned before, the respondent stated in her complaint that Snyman had told her that the Bluezone investment was guaranteed and that she was not warned about the risk involved in such an investment particularly after she questioned whether it would not be more advisable to retain the funds in an established fund.

31 The appellants, when called upon to deal with the complaint did not dispute these allegations. Apart from the fact that the complainant's allegations are accordingly deemed to have been admitted, Snyman provided corroboration for the allegation when she said that the request from the respondent was to reinvest in a similar type of investment as she had with Sanlam and that she had an aversion to risk.

32 Snyman thought that the product did not pose a risk to the complainant, she said, because she had been assured by the promotors of the scheme and their advertising brochures that the risk was low to moderate, whatever that means. (The brochure has a "risk indicator" which places the product between "moderately conservative" and "moderate" – not low to moderate. The lowest on the graph was "conservative".)

[5] The appellants argue that the product was the only one that gave both a fixed investment and the possibility of growth and that they consequently have fulfilled their mandate. If it was not possible to satisfy the complaint's requirements, Snyman should have told her so.

33 Snyman's opinion was reinforced by the fact that she believed that the investment was effectively in fixed property and that on an analysis of the lease which would have provided the return

> "the investors faced absolutely no risk whatsoever in respect of the building other than the usual market risks (i.e. that tenants fail to pay a rental or the total overall economy takes a substantial downturn)."

34 Snyman added that she believed that it was a solid investment and that the complainant would "not expose herself to unduly high risk". She relied on calculations that according to her indicated clearly that the property owning company and its holding company would be able to meet their commitment to pay the complainant her monthly interest and that there would in addition be capital appreciation of the property and consequently an appreciation of the investment.

35 Snyman also thought that the product did not pose a risk to the complainant because she thought that the FSB had approved the product. She was mistaken: the FSB does not approve products; it authorises the provision of classes of financial services and products.

THE PRODUCT

36 To unravel the complex structure of the Bluezone investment requires some doing and what follows is a broad summary.

37 The structure of agreement itself is unusual. It contains a large number of "recitals" which do not place any obligations on the Bluezone companies but misrepresent the

content of the agreement. There is a complete disconnect between the recitals and terms of the agreement.

38 Although the agreement purports to be a subscription of shares by the investor in a holding company, Pacific Breeze (Pty) Ltd, it was not a subscription of shares at all but instead a purchase of (inter alia) shares from third parties. Lest the significance escape the attention: money paid for subscribed shares forms part of the share capital of the company; money paid for the purchase of shares accrues to the seller and not the company.

39 It goes further. The sellers of the shares in Pacific Breeze were not identified and were also not parties to the agreement. The number of shares bought was also not quantified. In other words, the respondent bought from undisclosed shareholders of Pacific Breeze (the sellers) an unquantified number of their existing shares. (A share certificate issued later reflected 530 shares at R1 per share, which means that she paid R100 010 – the so-called subscription price – for 530 shares of R1 in a company without any disclosed assets.)

40 The balance of her investment was supposed to be reflected as loan capital. However, it was to be appropriated by Pacific Breeze to pay the unnamed sellers for the book value of their loan accounts (also described as claims) in Pacific Breeze. These values were not disclosed and it is not understood how there could be loan accounts in a company without any assets. Importantly the amount to be allocated to her shareholders' loan account was to be the R530 000 minus R100 010 (the shares) minus the book value at loan accounts at the date of sale.

41 Pacific Breeze would then use the "investment" (presumably the shareholders' loan account) to buy 85% of the shares in Copper Moon, which belonged to Bluezone (identified as the "principal"), for an undisclosed sum. Bluezone also had an unquantified loan account in Copper Moon.

42 Copper Moon, in turn would some time or other purchase the syndicated property from a third party and become the property holding company.

43 The property was subject to a lease and the income from the lease was represented to provide the investors their monthly return on their capital.

44 In other words, contrary to Snyman's belief, the investment was on the face of it not an investment in property or something akin to property; instead the investment was completely unsecured, had no underlying assets and was not guaranteed by any stretch of the imagination.

45 Although payment by the respondent had to be made to nominated attorneys, these payments were not to be kept in trust but were received on behalf of the holding company, Pacific Breeze, which was entitled to draw the money immediately from the attorneys. The attorneys were a mere conduit for the money. They provided no protection to investors and were introduced as a sop to them. In other words, Pacific Breeze was to receive payment and pay the unknown sellers before Copper Moon had even purchased the property or before Pacific Breeze had purchased the shares in Copper Moon.

46 In short, the claimant bought shares in a holding company (Pacific Breeze) of the so-called property owning company (Copper Moon) that had no property and merely had

the stated intention to purchase a property after payment and appropriation of the respondent's investment. It had not even entered into a binding contract of purchase and sale. The intended loan from Pacific Blue to Copper Moon was not quantified nor was the source sufficiently identified.

47 She had to pay R530 000 of which R100 010 plus the value of the claims went immediately into the pockets of the "sellers" and not into that of the holding company, and for the balance (if any) she had an unsecured loan account. However, her return in terms of the agreement would have been in 10.25% interest on her "loan account" which was represented to be on R530 000.

48 The agreed interest payments could be made provided that there were not more than 23 investors such as the respondent. But there was no limit to the number of subscriptions, shares, shareholders (save that under the then existing Companies Act of 1973, the maximum number of shareholder in a private company was 50) or shareholders' loans. The only qualification was that each subscriber had to pay "at least" R100 010, which means that other subscribers could have paid more and were entitled to a bigger slice of the cake. Snyman's reliance on the mathematical calculations was misplaced.

CONCLUSION ON THE ADVICE

49 As the Ombud said, there is no indication that Snyman explained to the respondent what the risks inherent in this property syndication were.[6] She could not because she did not understand this product. She was out of her depth.[7] The only risks that she identified related to those typical in respect of investments in fixed properties.

50 This is not an instance as Snyman suggested where the client, having been informed of the real risks, chose to accept the risk.

51 Snyman failed in her duty imposed by paragraph 8 of the Code,[8] i.e., to have identified a financial product appropriate to the client's risk profile and financial need. That is why she was prepared to state that the investment was "guaranteed" and why she downplayed or ignored the inherent risk in the product. She relied on the sales pitch of the promoters while not understanding the documentation.

52 This means that the appellants (a) breached their mandate, (b) acted in breach of their legal duties, and (c) were negligent in advising the complainant to invest in the product.[9] A reasonable FSP would not in relation to a new and complicated product have relied on the promotors only and would have obtained independent advice as to the merit of the product. *Imperitia culpae adnumeratur*: ignorance or incompetence is negligence.[10]

THE RECORD OF ADVICE

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[6] The submission that the Ombud should have obtained a statement from the respondent's erstwhile son-in-law who was present during the giving of advice misses the point because Snyman on her own version did not explain the risks inherent in the product.

[7] This does not imply that the Ombud's office understood the product – it did not even analyse it.

[8] General Code of Conduct for Authorised Financial Services Providers and Representatives BN 80 of 8 August 2003.

[9] *Durr v ABSA Bank Ltd* [1997] 3 All SA 1 (A); 1997 (3) SA 448) (SCA): the facts of the case are illuminating and relevant to this matter, as is the exposition of the law.

[10] M Swanepoel "The Development of The Interface between Law, Medicine and Psychiatry: Medico-Legal Perspectives in History" available at www.saflii.org/za/journals/PER/2009/20.rtf.

53 It is necessary to say something about the appellants' failure to have complied with para 9 of the Code, which deals with the record of advice. It provides to the extent relevant that an FSP must maintain a record of the advice furnished to a client and the record must reflect the basis on which the advice was given, and in particular—

- a brief summary of the information and material on which the advice was based; and
- the financial product or products recommended with an explanation of why the product or products selected, is or are likely to satisfy the client's identified needs and objectives.

54 When asked about the record of advice, the only answer was that it was in the present instance "somehow not utilised", which is not an explanation or excuse. The importance of the provision cannot be underestimated. It protects not only the client but also the FSP.

55 The Ombud would in appropriate circumstances be entitled to draw an adverse inference against an FSP who failed to keep such a record but in the light of the aforegoing finding it is not necessary to determine whether this was an appropriate case to have done so because the advice was on the appellants' own version bad.

56 The failure to keep a record of advice, on its own, will not necessarily be a cause of loss of an investment and, consequently, a ground for the Ombud to hold a FSP responsible for the ultimate loss. It would be for the Registrar to consider disciplinary steps in such circumstances. The function of the Ombud is not to discipline errant FSPs but to determine the rights of complainants against them.

CAUSATION

57 That leaves the question of causation, the principles of which were explained in *Standard Chartered Bank of Canada v Nedperm Bank Ltd* 1994 (4) SA 747 (AD); [1994] 2 All SA 524 (A). Causation has two legs, namely, factual and legal.

58 It cannot be gainsaid that the complainant lost her investment. The companies were liquidated. There was a compromise in terms of which the complainant was to receive shares in a company that had been suspended by the Johannesburg Stock Exchange. The information obtained by the Ombud was that there was no prospect that the investors would receive any payment.[11]

59 It can also not be disputed on the probabilities that if the complainant had not been misled in believing that the FSB had authorised the product she would not have made the investment. Likewise, if she had been told what the agreement meant, that the investment was not one in property, that there was an inherent risk of substantial capital loss in the syndication, she would not have made the investment.

60 This disposes of the factual inquiry because the bad advice was the *conditio sine qua non* of the loss.

61 That, as Corbett CJ said, does not conclude the enquiry. It is still necessary to determine legal causation, i e whether the furnishing of the poor advice was linked sufficiently closely or directly to the loss for legal liability to ensue, or whether the loss is too remote. The test

[11] The detail appears in para 26 of the supplementary determination.

"is a flexible one in which factors such as reasonable foreseeability, directness, the absence or presence of a , legal policy, reasonability, fairness and justice all play their part."

62 He added that

"the reasonable forseeability test does not require that the precise nature or the exact extent of the loss suffered or the precise manner of the harm occurring should have been reasonably foreseeable for liability to result. It is sufficient if the general nature of the harm suffered by the plaintiff and the general manner of the harm occurring was reasonably foreseeable."

63 The main factor limiting liability is the absence of reasonable foreseeability of harm. This is an objective question.

64 In the absence of any other explanation one has to conclude that the loss of her capital must have been the result of fraud because it is not explicable how an allegedly property holding company that was supposed to own a bond free property could in one year pay more than 10% by way of interest or dividend and during the next have no asset value.

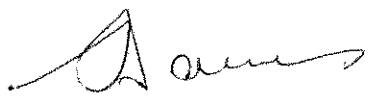
65 The Ombud found that the syndication was nothing more than a disguised Ponzi scheme from its inception and that it was public knowledge that the investment was a fraud on the public. She relied in this regard on a number of documents, all but one of which is publicly available. The appellants did not ask for the documents nor did they ask for the admission of further evidence to prove her wrong.

66 Fraud by directors is always foreseeable but the question is whether it was, at the time of the advice, "reasonably" foreseeable. The answer in this case is self-evident. The very nature of the contract – with holes through which a bus could drive and which had "fraud" written all over it – made the loss of the investment not only foreseeable but highly probable, if not inevitable. The fraud, consequently, cannot be regarded as a *novus actus interveniens.* The exact nature of the fraud is not relevant because it relates to the manner in which the loss was suffered and not to the legal foreseeability of loss. That means that the Ombud was correct in her findings on causation.

CONCLUSION

The appeal is dismissed. The appellant is to pay the costs of the first respondent.

Signed on behalf of the appeal panel.



LTC HARMS