IN THE OFFICE OF THE OMBUD FOR FINANCIAL SERVICES PROVIDERS

PRETORIA

Case Number: FAIS 04214/09-10/ NC1

In the matter between

SYDNEY PERUMAL NAIDOO	**Complainant**
and	
CHRISTIAAN JOHANN SWANEPOEL	**1st Respondent**
Jacob Johannes van Zyl	**2nd Respondent**
Hendrik Christoffel Lamprecht	**3rd Respondent**

DETERMINATION IN TERMS OF SECTION 28(1) OF THE FINANCIAL ADVISORY AND INTERMEDIARY SERVICES ACT 37 OF 2002 ("the FAIS Act").

A. THE PARTIES

[1] The Complainant is Mr. Sydney Perumal Naidoo, an adult male, employed as a Database Administrator, and who resides at House 168, Mancorpmine, 8420.

[2] The First Respondent is Mr. Christiaan Johann Swanepoel, an adult male, an Authorised Financial Services Provider whose address is PO Box 1310 Somerset West 7129. First Respondent at the time was a licensed provider with FSB license number of 11829. First Respondent's license was withdrawn by the Regulator on 13 December 2010.

[3] The Second Respondent is Mr Jacob Johannes van Zyl, an adult male, formerly a director of Blue Zone, and at all material times related to this matter as a Director, Key Individual, and Head of Commercial Legal Division of Blue Zone (Pty) Ltd and related companies. Second Respondent's address for purposes of this determination is the address of his attorney.

[4] The Third Respondent is Hendrik Christoffel Lamprecht, an adult male formerly a director of Blue Zone, who informed this office that he does not have a residential address, and who at all material times related to this matter, was also a Managing Director and co-founder of Blue Zone.

B. THE COMPLAINT

[5] On 29th November 2006, the Complainant engaged the First Respondent with a view to obtaining professional advice with regard to his investments. As a result of advice obtained, Complainant invested an

amount of R400 000 into Bluezone's Spitskop Village. Since liquidation of Bluezone in 2009, Complainant claims he has lost his entire investment..

[6] In the written complaint submitted to this office, the Complainant makes several allegations which could be summed up as follows:

6.1 That the First Respondent failed to disclose all material facts regarding the investment that the Complainant made in Blue Zone's Spitskop Village properties.

6.2 The First Respondent sent the disclosure documents by E-mail; however he failed to apprise the Complainant of the contents of the documents. In that regard, the Complainant alleges that there was never any discussion on the disclosure documents. It is worth noting that the disclosure documents run into several pages with equally bulky annexed documents.

6.3 The Complainant further states that the First Respondent never informed him that the monthly payments to him would be drawn from his capital. In that regard, the Complainant further states that had he been informed that the monthly payment would be paid out of his capital, he would not have taken the investment.

6.4 The Complainant asserts that the First Respondent failed to notify him that there was a land claim on the property or that the valuation on the property was incorrect.

[7] The Second and Third Respondents were the Directors of Blue Zone, and were the co-founders behind the formation of the Spitskop village project. The Spitskop village project was liquidated, and as a result investors such as the Complainant lost all their investments. The liquidation of the Spitskop project was a direct result of how that Company was run by the Directors. I deal with the circumstances of the collapse of the Spitskop Village project at some length in the Black v Moore[1] determination. I shall refer to the role of the Second and Third Respondents as directors of Blue Zone somewhat extensively below.

C. THE RESPONSE

[8] On 10th June 2010, the First Respondent submitted his Response to this Office. In his response, the First Respondent states that he was referred to the Complainant by the latter's brother during October 2006.

[9] The First Respondent then contacted the Complainant by telephone in the same month. After receiving a signed broker's appointment, he then gathered the necessary information regarding the Complainant's position.

[1] Black v Moore determination (Case Number: FAIS01110/10-11/WC1)

The First Respondent says he then conducted a full financial analysis of the Complainant. He further says he made different proposals to the Complainant and that the Spitskop Village/Blue Zone was one of many such proposals.

[10] On 22nd November 2006, the First Respondent states that he asked the Complainant to choose the Blue Zone Investment in order to address his investment needs.

[11] The First Respondent then states that he asked the Complainant to complete the 'risk analysis', and the result of which indicated that Complainant was a 'moderate risk investor'.

[12] In his submission, the First Respondent submits that Blue Zone, and in particular, the syndication investments are seen to be moderate risk investment vehicles and at that stage (when the investment was taken) produced an income of 9,5 % on capital, whilst banks offered 7 % with no chance of capital growth.

[13] He disputes the Complainant's assertion that he did not know that monthly payments would be made from his capital "for a period of time". The implication is that the First Respondent was aware that 'monthly payments' would be made out of Complainant's capital. There is no record

that First Respondent explained to the Complainant that "for some time" payments would be made from the capital.

[14] The First Respondent mentions that the investment was kept in the trust account of Honey & Partners, and was expected to bear interest. He further submits that, on his understanding of the scheme, the money would be kept in the attorneys trust account and that if the scheme was not realised then investors would be refunded their capital plus interest from the attorneys' trust account.

[15] Explaining the reason for drawing the monthly payment from the capital amount, the First Respondent states that "the product can be structured in such a way that this deficit would have been made up as soon as the property (Steelpoort) was sold.

[16] The First Respondent further states that he was registered as a representative on the Blue Zone licence to provide advice on shares and debentures whilst marketing their product. Apart from this submission, First Respondent provides no proof that the requirements of section 13 of the FAIS Act were met. As will appear elsewhere in this determination, First Respondent readily admits that he received no training in respect of this product.

[17] Complainant invested an amount of R400 000 into Blue Zone. As a result, First Respondent earned 6% commission on this investment.

[18] The First Respondent submits that the commission he received is market related for this type of investment. He then further states that an 80 page full disclosure of all costs, fees and product description was provided to all the investors. Once the investors had read the disclosure documents, they were required to sign a form acknowledging having read the documents. The First Respondent then submits that the Complainant signed and returned the form acknowledging that he had read the disclosure documents.

[19] Although the First Respondent mentions in his response that all his actions were as a result of 'intensive investigations of the Steelpoort project", he furnishes no documentary proof showing what these "intensive investigations" comprised of.

[20] The Respondent then attached various documents, including a letter of introduction, broker's appointment, financial needs analysis, and the record of advice. However, it must be stated that the documents furnished do not lend credence to the First Respondent's assertion that he complied with the provisions of the FAIS Act and Code.

[21] The provisions of section 2 of the General Code states as follows:

"A provider must at all times render financial services honestly, fairly, with due skill, care and diligence, and in the interests of clients and the integrity of the financial services industry."

[22] It is appropriate to quote (*vebatum*) directly from paragraph 7 of the First Respondent's response, as it is instructive:

"I dealt with Mr Naidoo myself. My needs analysis for Mr Naidoo showed that a diversified investment approach was required. A total amount of R400 000 of the available R545 658 was invested in Steelpoort. This R400 000 would have generated a monthly income and some capital growth after finalization of the development. This monthly income, I suggested to be paid towards a unit trust type of investment. All my actions was done after intensive investigations to the Steelpoort project. I stayed at Middelburg (some 15 years) some 300 km away from the Steelpoort development and new the potential of the ground and such projects as I visited the area regularly as a Metallurgical engineer. Never at any stage could I contemplate that this could happen to this project. My own funds, but also my mother and fiancés funds were invested towards Steelpoort." (sic)

[23] In a letter sent to this Office on 27th July 2010, the First Respondent stated that he relied entirely on Blue Zone for advice on the correct procedures he had to follow in selling and marketing the Spitskop investment. The First Respondent was candid enough to admit that he relied entirely on Blue Zone.

[24] The First Respondent then states that he was approached by one Pieter Loubser from Blue Zone who introduced him to the Spitskop investment.

[25] The First Respondent further states that with hindsight, he now knows that he should have received guidance and assistance by a mentor appointed by Blue Zone in Marketing the product for a period of time, and that this process should have been documented and monitored. Tellingly, the First Respondent then states that had the necessary requirements been complied with, "the errors in terms of disclosures might have been detected in time".

The significance of this admission, by the First Respondent, is that in effect he is saying that had he and Blue Zone complied with section 13 of the Act, he would have been in a better position to make an assessment of the Blue Zone product.

[26] The First Respondent also mentions that he attended a product orientation course with Blue Zone where the product was discussed in detail.

[27] The First Respondent further states that he provided the advice honestly, and frankly, with due care and diligence in the best interest of the client. In that regard, the First Respondent then attaches a document which he describes as the 'due diligence' that he compiled. I deal with this document later in this determination.

[28] The First Respondent then submitted that he did not have a compliance officer who could have guided him in terms of replacement of products. He states that he was always under the impression that 'a replacement questionnaire' was only required where life assurance was concerned and not in collective investment. Again, this aspect merits some consideration, and I deal with it at some length below.

[29] It is not in dispute that the Complainant had an investment of R545 658 in Old Mutual. The First Respondent advised Complainant that such investment was not performing well enough and recommended the Blue Zone product. In effect, the First Respondent advised the Complainant to replace an existing investment with the Blue Zone product. The consequence of this is that the First Respondent was expected to comply with section 8 of the General Code.

[30] Section 8 (1) (d) provides as follows:

"where the financial product ("the replacement product") is to replace an existing financial product wholly or partially ("the terminated product") held by the client, fully disclose to the client the actual and potential financial implications, costs and consequences of such a replacement, including, where applicable, full details of-

(i) fees and charges in respect of the replacement product compared to those in respect of the terminated product;

[Subpara (i) substituted by BN 43/2008 with effect from 14 May 2008]

(ii) special terms and conditions, exclusions of liability, waiting periods, loadings, penalties, excesses, restrictions or circumstances in which benefits will not be provided, which may be applicable to the replacement product compared to those applicable to the terminated product;

[Subpara (ii) substituted by BN 43/2008 with effect from 14 May 2008]

(iii) in the case of an insurance product, the impact of age and health changes on the premium payable;

(iv) differences between the tax implications of the replacement product and the terminated product;

(v) material differences between the investment risk of the replacement product and the terminated product;

(vi) penalties or unrecovered expenses deductible or payable due to termination of the terminated product;

(vii) to what extent the replacement product is readily realisable or the relevant funds accessible, compared to the terminated product;

[Subpara (vii) substituted by BN 43/2008 with effect from 14 May 2008]

(viii) vested rights, minimum guaranteed benefits or other guarantees or benefits which will be lost as a result of the replacement; and;

[Subpara (viii) substituted by BN 43/2008 with effect from 14 May 2008]

(ix) any incentive, remuneration, consideration, commission, fee or brokerages received, directly or indirectly, by the provider on the terminated product and any incentive, remuneration, consideration, commission, fee or brokerages payable, directly or indirectly, to the provider on the replacement product where the provider rendered financial services on both the terminated and replacement product."

[Subpara (ix) inserted by BN 43/2008 with effect from 14 May 2008]

[31] On the First Respondent's own version he failed to comply with the provisions of section 8(1)(d) of the General Code. It is significant that the First Respondent's own "risk analysis" of the Complainant showed the latter to be a "moderate risk" investor. Furthermore, First Respondent was aware of Complainant's recent investment history and the latter's risk profile. First Respondent nevertheless advised Complainant to invest in Blue Zone.

D. SECOND AND THIRD RESPONDENTS

[32] Second and Third Respondents were sent letters in terms of section 27(4) of the FAIS Act. To date this Office only received a response from the Second Respondent's attorney whilst the Third Respondent elected not to respond at all.

[33] For his part the Second Respondent mentioned to this Office that he was in no position to deal with the allegations that this was a scam investment.

[34] In effect, the Second Respondent's Response was merely to refer this Office to the fact that Blue Zone and its sister companies are in liquidation and we were given details of the trustees. The Second and Third Respondents refused to deal with the merits of the Complaint.

E. PIERCING THE CORPORATE VEIL

[35] In the *Cape Pacific Ltd v Lubner Controlling Investments (Pty)Ltd* and Others[2], the court explained the concept of 'piercing the corporate veil' as follows:

> "It is trite law that '(a) registered company is a legal persona distinct from the members who compose it' (Dadoo Ltd and Others v Krugersdorp Municipality Council 1920 AD 530 at 550). Equally trite is the fact that a court would be justified in certain circumstances in disregarding a company's separate personality in order to fix liability elsewhere for what are ostensibly acts of the company. This is generally referred to as lifting or piercing the corporate veil. (I shall confine myself to the use of the word piercing.) The focus then shifts from the company to the natural person behind it or in control of its activities) as if there were no dichotomy between such person and the company (Henochsberg on the Companies Act 5th ed vol 1 at 54). In that way personal liability is attributed to someone who misuses or abuses the principle of corporate personality."

[2] 1995 (4) SA 790 (A) at 802

[36] The court went further to enunciate the grounds on which the company's separate personality could be disregarded and hold the directors liable. In that connection the court pertinently held as follows:

"it is undoubtedly a salutary principle that our Courts should not lightly disregard a company's separate personality, but should strive to give effect to and uphold it. To do otherwise would negate or undermine the policy and principles that underpin the concept of separate corporate personality and the legal consequences that attach to it. But where fraud, dishonesty or other improper conduct (and I confine myself to such situations) is found to be present, other considerations will come into play. The need to preserve the separate corporate identity would in such circumstances have to be balanced against policy considerations which arise in favour of piercing the corporate veil (cf Domanski 'Piercing the Corporate Veil-A New Direction' 91986) 103 SALJ 224). And a court would then be entitled to look to substance rather than the form in order to arrive at the true facts, and if there has been a misuse of corporate personality, to disregard it and attribute liability where it should rightly lie. Each case would obviously have to be considered on its own merits."[3]

[37] The Disclosure Documents of Blue Zone indicate the following unsettling facts:

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[3] *Cape Pacific Ltd v Lubner Controlling Investments (Pty)Ltd* and Others (see note 2, above), at 804

37.1 On 12th May 2003, Blue Dot Properties 1330 Ltd, the directors of which were the Second and Third Respondents, bought a piece of land in the farm Spitskop for an amount of R1 057 000.00.

37.2 The same piece of land, referred to above, was then sold to Spitskop Village Properties Limited in an amount of R118 million. It must be mentioned that the land concerned was a piece of agricultural land, and there is no evidence that any development or improvements ever took place on the land. The land was a vacant farmland with no services or improvements.

[38] The meteoric rise in the value of the land, from just over R1million in 2003, to R 118 million in 2006 was attributable to a so-called "desk top valuation" which was carried out by valuators who were instructed by the Second and Third Respondents. There is no economic or rational basis for explaining the leap in value of the unused agricultural land which justified its selling to Spitskop for R118million, which purchase price was paid using investors' money. As pointed out in the Black determination, the two moving spirits behind Blue Zone were the Second and Third Respondents. These two Respondents seem to have benefited handsomely from the transactions which involved the selling of the land to Spitskop. Regrettably, the investors were not adequately protected and did not benefit from the deal and in fact lost their money.

F. THE LIABILITY OF THE DIRECTORS

[39] The common thread running through all the failed investments that have come before this Office is that once the scheme has collapsed, the companies are placed into liquidation and the investors are left high and dry. The directors then simply hide behind the liquidation process and successfully divert attention from the fact that they swindled members of the public.

[40] The investors are then left to their own devices. The directors of these failed schemes are hardly ever affected. This is the case as they are protected by the legal fiction in terms of which the company has a separate personality. In most of these schemes the fraud appears to have been conceived from the inception of the company. The company, which often has no assets, then embarks on an aggressive campaign to market the scheme to members of the public. I need not repeat the salient features of these schemes as they are adequately dealt with in the Black v Moore determination[4]. It suffices merely to mention that the directors of these failed investment schemes are often the masterminds and beneficiaries of these fraudulent schemes. It is they, who pocket the investors' funds, and having run the companies to the ground, they then escape unscathed as the company goes through liquidation. All the while, the investors are the prime losers as they hardly ever manage to salvage even a fraction of their investments. In most cases they suffer the further

[4] Black v Moore determination (Case Number: FAIS01110/10-11/WC1)

risk of losing more money if called upon by the liquidators to make a contribution.

In my experience most of these failed investments are nothing more than disguised pyramid schemes.

[41] In the present matter, as in all the Blue Zone complaints, the directors clearly ran the Spitskop scheme fraudulently. The list of factors which indicate an intention to defraud investors are extensively dealt with in the Black matter[5]. There can be no doubt that by running the Blue Zone scheme fraudulently, the directors of Blue Zone opened themselves up to personal liability.

[43] The primary purpose of the FAIS Act is to protect the consumer and strengthen the integrity of the financial services industry. It therefore seems to me that the time has come for this Office to look beyond the corporate veil that protects the directors of these companies that perpetrate these fraudulent investment schemes.

[44] In most instances, these directors escape the prosecution net, and the question then arises as to how one stops the rampant fraud perpetrated by these investment schemes against ordinary members of the public? It seems to me that one of the weapons at my disposal would be to pierce

[5] See Black v Moore, in note 1, above.

the corporate veil and hold the directors personally liable. This should be the case in all those instances where there is clear evidence that the investment scheme or the property syndication company is being run fraudulently, or with the intention of defrauding the investors.

[45] In the present matter, the inference is entirely inescapable that the whole scheme is a fraud and that the directors of Blue Zone were party to the perpetration of such fraud.

[46] A telling example of the Blue Zone's directors' culpability in the fraud relates to their actions once the reports about the legality of the scheme started surfacing. The directors of Blue Zone issued a document signed by Second Respondent which urged the investors to ignore a South African Police Services notice. The latter notice was cautioning investors and alerting them to possible breaches of the law by the Spitskop project, and by extension by Blue Zone. In that regard, Second Respondent went out of his way to advise the investors to ignore the SAPS letter. He further stated that the investors' funds were sound. This was at the time when it should have been clear to the directors of Blue Zone that their proposed scheme was possibly in breach of various legislation, as set out in the SAPS letter.

[47] When the scheme was clearly heading for liquidation, Second Respondent who is a qualified and experienced attorney advised the investors that all was well with the investors' funds. In the same breath, when it should have been apparent that the Spitskop project had not got off the ground, Second Respondent wrote to the investors assuring them that the project was "progressing well ahead of schedule". Surely, all these assurances by the directors of Blue Zone were designed to mislead the unsuspecting investors.

[48] There is no reason why in fact and in law, the directors of Blue Zone should not be held personally liable for the failed investment scheme. This should be the case as the directors of Blue Zone have not accounted for the investors' funds. In fact, as set out in the Black determination, the Spitskop project never commenced, and yet the investors' funds amounting to about R425 million Rand remained unaccounted for and not refunded to the investor as the law demands.

[49] According to the report compiled by LDP Inc which supplied an audit report on the investors' funds, the Spitskop project was subscribed to the tune of R 391, 600, 771, 66. On the other hand, Bester, a financial director of Blue Zone, advised the FSB Inspectors that the project was fully subscribed at R425 million Rands. However, neither Bester nor the company provided any proof that the subscription threshold had been reached. To compound matters further, in a letter dated 03 August 2009,

van Zyl wrote on behalf of the directors of Blue Zone and informed the investors that:

"it is not true that an amount of R425 m was paid. As already communicated to shareholders only an amount of R361m was raised."

[50] It is noteworthy to mention that at the time of writing this letter Blue Zone was no longer marketing the investment.

[51] The unsavoury role played by the directors of Blue Zone has been canvassed in the Black v Moore determination. The Disclosure Documents, and other correspondence in my possession which have been furnished to this Office by both the Complainant and the Respondents, indicate that the Second and Third Respondents as directors of Blue Zone, Spitskop and Blue Dot, were involved in the following:

(a) They were both the directors of Blue Zone, Spitskop and Blue Dot companies.

(b) They signed an agreement which purported to sell the property from Blue Dot to Spitskop. Significantly, the board resolutions to buy and sell were taken by both directors (van Zyl and Lamprecht) in their dual capacities as directors of Spitskop, on the one hand, and Blue Dot, on the other.

(c) The purchase price of the property was grossly overstated and not in line with market prices for similar properties in the area of Spitskop in 2006.

(d) The purchase price of the property was arbitrarily determined by Lamprecht. It is clear that the inflated valuations conducted by Seyffert and Marais were only designed to provide justification for the consequent overstatement of the purchase price.

(e) The purchase and sale agreement was provided for Spitskop to start paying the money to Blue Dot even before the land was transferred to Spitskop. No interest was paid to Spitskop for these advances. The money in Spitskop came straight from the investors' pockets.

(f) Consequently, the investors were made to pay in excess of R116.8 million (R118.3 minus R1.5 million plus lost interest) without receiving any value in return. [6]

[6] Financial Services Board's Report on Blue Zone, Blue Dot, and Spitskop Village Properties, Inspection under section 3 of the Inspection of Financial Institutions Act, No. 80 of 1998, pages 78-79

[52] The conduct of the directors of Blue Zone, in particular, Second and Third Respondents is appalling to say the least. They deliberately misled the investors as to the true state of affairs in the Spitskop project. Of particular significance is the fact that the directors never appointed an audit committee for Spitskop which was in contravention of section 269 A (1) of the Companies Act states the following:

"In every financial year in which a company is a widely held company, its board of directors shall appoint an audit committee for the following year."

[53] There is no record of compliance with the mentioned section 269A (1) by Spitskop or any of the Blue Zone companies. As a result, the investors were prejudiced. The continued selling of such a flawed product was thus in contravention of the FAIS Act and General Code. The directors of Spitskop and Blue Zone were aware of the flaws of the Spitskop project.

[54] Accordingly, the Second and Third Respondent must be held liable for the loss incurred by the Complainant in the present matter. Similarly, the broker who sold the toxic investment should not escape liability. The basis for the representative's liability is extensively set out in the Black determination. I need not repeat the principles set out in the Black matter.

G. DIRECTORS' LIABILITY IN TERMS OF THE FAIS ACT

[55] In this determination I have already set out the basis for directors' liability in the common law. I now deal with a further basis for the directors' liability which is founded in the FAIS Act.

[56] As a general rule, Section 7 of the FAIS Act states that no one may act as an FSP without a valid licence.

[57] As set out more fully below, section 13 (i) (bb) of the FAIS Act attributes the actions of the representatives to the licensed provider.

[58] The Act then creates an exception in section 13 where a person may act as an intermediary without a formal license but provided that certain conditions are met.

[59] Section 13 while creating an exception has not created a situation where members of the public are rendered vulnerable.

[60] Technically, a representative in terms of section 13 does not necessarily have to be licensed by the FSB as contemplated in section 7 and 8.

[61] On a proper interpretation of section 13 a person who is not licensed in terms of section 8 of the FAIS Act can be appointed as a representative of a licensed provider. However, the Act does not make it easy to merely appoint someone as certain terms and conditions must be met.

[62] These provisions are there to offer protection to members of the public. If not, then members of the public are not protected because it is possible for an unqualified person to be appointed as a representative leaving the question of competence entirely to the provider who must ensure that the principles of fit and proper as contemplated in the FAIS Act are adhered to.

[63] The Act states that the provider is responsible for the actions of the representative. That being the case, surely if the representative sells a toxic investment , marketed by the very provider, then such provider must also be held responsible for the consequences of such marketing.

I have held that the representative, in terms of section 13, is liable for reasons set out more fully in the Black determination.

[64] The provider is normally a company, but in granting a license, the regulator will look at the competence of the key individual, who is usually a director of the providing company. In those cases where the investment scheme fails as a result of fraud, then the directors must be held liable.

[65] In terms of section 13, the Representative as well as the provider, or principal and Representative must be held liable for the loss where it was incurred by the breach of the provisions of the FAIS Act.

H. THE APPOINTMENT OF REPRESENTATIIVES AND THE CONSEQUENCES

[66] Section 7 of the FAIS Act provides as follows:

"a person may not act or offer to act as a financial services provider unless such person has been issued with a licence under

[67] Section 13 of the FAIS Act provides as follows:

"13. Qualifications of representatives and duties of authorised financial services providers

(1)A person may not -

(a) carry on business by rendering financial services to clients for or on behalf of any person who -

(i) is not authorised as a financial services provider; and

(ii) is not exempted from the application of this Act relating to the rendering of a financial service; or

(Commencement date of para. (a): 30 September 2004)

(b) act as a representative of an authorised financial services provider, unless such person-

(i) is able to provide confirmation, certified by the provider, to clients -

(aa) that a service contract or other mandate, to represent the provider, exists; and

(bb) <u>that the provider accepts responsibility for those activities of the representative performed within the scope of, or in the course of implementing, any such contract or mandate</u>;"

(emphasis mine)

[68] On a proper reading of the Act, the provider, in appointing a representative, must comply with the following four requirements of the FAIS Act :

68.1 Step one: The provider must comply with section 8 of the FAIS Act;

68.2 Step two: There must be a written mandate or contract between the provider and the representative;

68.3 Step three: The provider must accept written responsibility for the actions or conduct of the representative;

68.4 Step four: The representative must be qualified to render financial service in respect of the product, the onus being on the provider to provide the necessary training.

[69] From what I have seen, many of the providers do not take the abovementioned steps in appointing a representative. They merely use

section 13 as a loophole to indiscriminately appoint representatives based on their own licenses.

[70] These representatives are invariably unlicensed and unqualified to sell the product. The Act however places responsibility on the licensed provider to ensure that the representative has the capacity to properly advise members of the public.

[71] As I have pointed out in the Black decision, on Blue Zone's own records they appointed some 580 representatives. In the time that they had, it is simply impossible to comply with section 13 in respect of 580 representatives. I saw no evidence of such compliance taking place, instead what I saw were standard documents that were produced by Blue Zone which purported to comply with section 13.

[72] Many of these representatives, including the First Respondent, openly admit that they did not receive any training from Blue Zone.

[73] Clearly, there is no loophole to be exploited in the Act. The Act properly regulates the appointment of representatives by licensed service providers. It is the licensed providers who often act in breach of the applicable provisions of the FAIS Act and Code. The present matter and

the Black case are perfect examples of the flagrant breach of section 13 by licensed service providers.

[74] The reference in section 7 to the appointment of representatives is a reference to section 13. A proper analysis of what is meant by section 13 is as follows.

[75] On a proper interpretation of section 13, the following are the requirements for the purpose of appointing a representative. I now expand on the four steps mentioned above:

75.1 First Step. The provider must satisfy themselves that the representative complies with the standard as contemplated in section 8 of the Act. In particular, the provider must satisfy himself that the representative meets that fit and proper requirements of section 8. This means that the Act requires the provider to carefully consider the character and competence of the representative before the latter is appointed.

75.2 Second Step. The provider must train the representative and provide the latter with relevant information regarding the product to be marketed.

The Act requires the provider to ensure that the representative actually understands the product and is capable of advising members of the public.

75.3 Third Step. The provider is then obliged to enter into a written contract or provide a written mandate to the representative. The Act contemplates that the representative must be provided with written authorization to sell the product to members of the public on behalf of the provider.

75.4 Fourth Step. The provider must certify or accept in writing or give a written undertaking that they will be responsible for "those activities of the representative performed within the scope of or in the course of implementing any such contract or mandate".

[76] The Act contemplates that members of the public receive assurance of the provider that they will be protected at all times.

[77] Having completed the above-mentioned steps, the representative is now ready to market the product. It must then follow that if the provider fails to carry out one or more of the above steps, the representative cannot be appointed in terms of section 13. It was never intended that the provider could appoint a representative simply with the stroke of a pen.

[78] It is worth examining the most important provision of the FAIS Act in section 13 (1) (bb).

[79] For convenience, I repeat what the subsection provides:

> "(bb) that **the provider accepts responsibility for** those activities of the representative performed within the scope of, or in the course of implementing, any such contract or mandate;"
> (emphasis mine)

[80] On the plain meaning of the subsection, the provider will be held liable for any loss caused by the representative to members of the public, provided that such loss was "caused within the scope of, or in the course of implementing" the providers mandate or contract.

[81] A simple example of this will be where the representative in selling the product then steals the investors' money. Surely the provider must be held equally liable for the following acts of the representative:

81.1 Where the representative advised the client to invest in the provider's product where the said product was inappropriate for the investor considering the investor's profile, and

81.2 The provider must be held responsible for his representative's act of selling the product itself where the said product amounts to a toxic investment.

[83] Upon a proper interpretation of section 13, the directors or key individuals of provider must be held liable for the consequences of their own products going wrong.

[84] Second and Third Respondents set out from the onset to swindle the investors of their funds. They appointed hundreds of representatives to exploit members of the public without complying with section 13 of the Act.

[85] For these reasons the Second and Third respondents must be held liable for the Complainant's loss.

[86] Returning to the First Respondent, there are numerous facts which are a cause for concern. The First Respondent only met the Complainant at a shopping Mall in Durban. It appears that there was never a formal meeting and consultation between the parties to discuss investments. Yet if one considers that R400 000 was at stake, one has to ask a question why the parties had to meet by sheer chance at a shopping Mall on some Saturday. Both the Complainant and the First Respondent were on

holiday at the time of their meeting in Durban. The Complainant says the meeting did not go to the heart of the investment, but that he was sent the Blue Zone marketing material, which included disclosure documents, via e-mail.

[87] The results of the risk analysis indicated that the Complainant was a 'moderate risk investor'. First Respondent's description of the Blue Zone scheme as being suitable for 'moderate investors' is unsettling. Anyone with a cursory acquaintance with unlisted shares and debentures would have been alert to the risky nature of these investments. To compound matters, Blue Zone had absolutely no track record by which it could be judged. That made it all the more imperative for the broker to exercise caution when advising clients to invest in the Blue Zone Scheme.

[88] It is not clear in what way the First Respondent conducted proper due diligence of the scheme. A document which First Respondent attached to his response purports to be a due diligence investigation of the Spitskop/Steelpoort scheme raises questions. On the surface, the document reads quite impressively. On the First Respondent's version, he must have drafted this document before the Complainant invested in the scheme. This Office however, received many complaints from Blue Zone investors. Amongst documents received I found this very "due diligence" document relied on by the First Respondent. The document which the

First Respondent passes off as his due diligence appears to have been drafted by the Blue Zone directors after the collapse of the scheme.

[89] It was addressed to all the brokers and explains how the scheme was conceived and what its pitfalls and advantages were. It is regrettable that the First Respondent sought to mislead this Office by misrepresenting that he drafted the document as a result of his own due diligence. The fact is that what the First Respondent passes off as his document was in fact drafted months after the collapse of the Blue Zone scheme. In this regard, the date of the original document is 12th May 2010, whereas the First Respondent tries to create the impression that he drafted the document himself. The original report was drafted by Mr. Riaan van Zyl who is a former sales director of Blue Zone. Regrettably, the First Respondent excised the date on which the document was drafted and failed to acknowledge the source of the document.

[90] The First Respondent's comment that with the benefit of hindsight he ought to have had a mentor is instructive. The contrition goes to the heart of the significance of strict compliance with the provisions of section 13 as discussed above and in the Black determination. By his own admission, the First Respondent was not adequately trained to market or sell shares. His analytical grasp of what the Blue Zone products entailed appears, at best, to be rudimentary. The First Respondent, by his own admission, was out of his depth. In this regard, I refer to the case of Durr v ABSA Bank.

[91] The First Respondent was not only unlicensed to market shares and debentures, he received absolutely no training and support from Blue Zone. The First Respondent relied almost entirely on the glossy marketing material of Blue Zone. The fact that the First Respondent was not properly or adequately trained indicates that the investors were not protected.

I. CONCLUSIONS

[92] On the undisputed facts before this Office the following conclusions are made:

92.1 The First Respondent failed to make an independent and objective assessment of the Blue Zone product.

92.2 The First Respondent as a representative held himself out as an expert in the product he sold to the Complainant.

92.3 The Complainant was dependent on the First Respondent for professional and sound advice on the appropriate investment he needed to make.

92.4 The First Respondent purported to conduct the necessary needs and risk analysis of the Complainant.

92.5 The results of the needs and risk analysis indicated that the Complainant was a "moderate investor".

92.6 Despite the results of the complainant's risk analysis, the First Respondent invested the Complainant's money into the Spitskop project, which was a high risk investment.

92.7 The First Respondent was not qualified to deal in unlisted shares and securities, nor was he licensed to do so.

92.8 The First Respondent relied almost exclusively on the glossy marketing material of Blue Zone and did not conduct any independent analysis in making his assessment of the Spitskop project.

92.9 The First Respondent breached various provisions of the FAIS Act and General Code, and is therefore liable to the Complainant.

92.10 The Second and Third Respondents are liable for Complainant's loss both in terms of the common law and the FAIS Act for the reasons advanced in this determination.

[93] In the premises, the complaint is upheld and the Respondents are liable to pay the complainant's claim.

J. HONEY ATTORNEYS

[94] In the Black determination I was critical about the role of Honey Attorneys in the Blue Zone/Spitskop investment scheme. Generally, this firm of attorneys was retained to advise Blue Zone and its sister companies in the investment schemes, including the Spitskop village project. I need not repeat the concerns expressed in the Black determination about the conduct of Honey & Partners. In this matter, there is an important aspect concerning Honey &Partners which merits some attention.

[95] The Complainant brought the following facts to the attention of this office:

95.1 After submitting his complaint to this Office, the Complainant enquired from Honey & Partners as to what happened to the interest on his investment that was held in their trust account;

95.2 Correspondence submitted to this Office between Mr. H.E Van Der Walt of Honey Attorneys and the Complainant, indicates that after threatening to report the conduct of the Firm to the Law Society and the Fidelity Fund, Honey & Partners undertook, and indeed paid the Complainant what they stated was his "interest" from the trust account;

95.3 There is no explanation from Honey & Partners as to why the Complainant was not paid his interest from the trust account when it fell due. The question then arises as to why the Complainant was not paid his interest, and that how many of the investors have never been paid their interest by Honey &Partners? The further question that arises is, where did the money, paid to the Complainant, suddenly appear from? If it came from the firm's business account, then the firm has to explain how and why the Complainant's money came to be transferred from the trust account into the business account. If the money was paid from the trust account, then the firm has to explain why it never accounted for these funds to the Complainant. I must add that I am aware that other investors were also recently paid their interest. This is obviously a matter for the law society.

95.4 It must be emphasised that the disclosure documents state clearly that the investors' funds were to be placed in an interest bearing trust account of Honey & Partners, and that should the subscription threshold of R425 million not be reached, the investors would be refunded their monies. The Complainant has enquired if he would indeed be refunded his money. At this stage, I must indicate that all attempts to enquire from Honey & Partners how the investors' funds were handled have been met with uncooperative, unhelpful, and vague responses.

This is another matter that requires the attention of the Law Society and the Fidelity Fund.

K. QUANTUM

[96] The First Respondent invested an amount of R400 000.00 of Complainant's money in the Spitskop Project. There is no prospect of recovering any amount from Spitskop or Blue Zone.

[97] Accordingly an order will be made that Respondents pay to complainant an amount of R400, 000.00. Interest will be awarded on this amount.

THE ORDER

I make the following order:

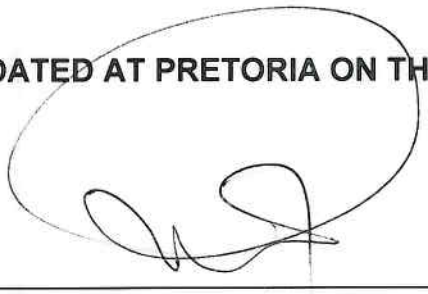
1. The complaint is upheld,
2. The Respondents are ordered to pay to the complainant, jointly and severally, the one paying, the other to be absolved:

2.1 The amount of R400, 000.00

2.2 Interest on the amount of R400, 000.00 at the rate of 15, 5% per annum from the 1st February 2007 to date of payment.

3. The First, Second and Third Respondents are each ordered to pay the case fee of R1000, 00 to this office within thirty (30) days of date of this determination.

DATED AT PRETORIA ON THIS THE 7th MARCH 2011.



NOLUNTU N BAM

OMBUD FOR FINANCIAL SERVICES PROVIDERS