25 January 2013

IN THE NORTH GAUTENG HIGH COURT
OF SOUTH AFRICA
PRETORIA

CASE NO: 56193/12

In the matter between:

FRANCOIS BARNARD	1st Intervening Party
THABO PANDLETON MABETA	2nd Intervening Party
BISNATH (JAY) SINGH	3rd Intervening Party
GAVIN JOHN GRIFFIN	4th Intervening Party
MICHAEL WRIGHT	5th Intervening Party
MARK DAWSON	6th Intervening Party
AMELIA HOLLAND	7th Intervening Party
EBEN LOFTY VAN WYK	8th Intervening Party
PETRUS JOHANNES KRIEL	9th Intervening Party
FRANCOIS ALBERT PIETERSE	10th Intervening Party

In re:

THE REGISTRAR OF MEDICAL SCHEMES Applicant

and

MEDSHIELD MEDICAL SCHEME Respondent

JUDGMENT

MURPHY J

1. The applicant is the Registrar of Medical Schemes ("the Registrar") appointed in terms of section 18 of the Medical Schemes Act [1]("the MSA"). Section 18(2) of the MSA provides that the Registrar is the executive officer of the Council for Medical Schemes ("the Council") and has responsibility for managing the affairs of the Council in accordance with the provisions of the MSA and the policy and directions of the Council.

[1] Act 131 of 1998

The Council, established in terms of section 3 of the MSA, functions as the regulator in the medical schemes industry and is required, *inter alia*, to control and co-ordinate the functioning of medical schemes in a manner that is complementary with national health policy; to protect the interests of medical scheme beneficiaries; to investigate complaints and settle disputes in relation to the affairs of medical schemes; and to advise the Minister of Health on matters concerning medical schemes.[2]

2. The respondent is Medshield Medical Scheme ("the Scheme"), an open medical scheme where membership is not restricted to persons by virtue of their employment, but is open to any member of the public. The Scheme is the fourth largest open scheme in the country, with approximately 207 000 beneficiaries.

3. On 2 October 2012, the Registrar obtained a provisional order placing the Scheme under curatorship. The application was brought on an *ex parte* urgent basis *in camera* before van der Merwe DJP who granted an order appointing a provisional curator pending the outcome of the return date of a rule *nisi* issued calling upon the Scheme and other interested persons to show cause why a final order of curatorship should not be granted. The provisional curator was given comprehensive powers, subject to the authority of the Registrar, to take control of the business and management of the Scheme. The provisional appointment effectively removed all authority from the board of trustees of the Scheme. In the event of the provisional curatorship being confirmed, the curator is directed to report to the Registrar within 12 months and to include in his report a statement of his findings and recommendations. The curator will be required within 12 months to take all steps necessary to convene a special general meeting of the Scheme for the election of a new board of trustees.

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[2] Section 7 of the MSA

4. On 22 October 2012 the trustees filed an application seeking leave to intervene in the application for curatorship, for an order allowing them to oppose it and an order discharging the rule *nisi* and dismissing the Registrar's application. To this end they filed answering affidavits. The application to intervene was not opposed. In view of that, I granted leave to intervene and oppose at the commencement of the hearing.

5. Prior to the hearing of the application, the provisional curator produced an interim report dated 29 October 2012 in which he raised pertinent concerns about the administration and governance of the Scheme. The report prompted the Registrar in his replying affidavit to supplement the grounds in support of the application for the appointment of a curator. He accordingly invited the trustees, as the intervening parties, to file further affidavits dealing with the new matter raised in the replying affidavits. The trustees then filed supplementary opposing duplicating affidavits to which the Registrar has replied.

6. The return day of the rule *nisi* was extended to 15 November 2012 when the matter was argued and all the issues were fully ventilated before me.

The statutory provisions governing the appointment of a curator

7. The Registrar, if he has regulatory concerns regarding a medical scheme, may seek the appointment of a curator either in terms of section 56 of the MSA or in terms of section 5 the Financial Institutions (Protection of Funds) Act 28 of 2001 ("the FIA"). The pre-conditions for the grant of relief under the two sections differ. The MSA requires the Registrar to hold the opinion that an appointment will be in the interest of the beneficiaries; or that it is desirable because material irregularities may have occurred or that the scheme is not in a sound financial condition. The FIA merely expects good cause for an appointment to be shown. The Scheme

submitted that once the Registrar has elected to act under section 56 of the MSA he is precluded from relying on section 5 of the FIA. The Registrar argued that he is entitled to proceed under both provisions, or either, as he chooses.

8. In the founding affidavit, the Registrar stated that he was bringing the application, with the concurrence of the Council, in terms of section 56 of the MSA read together with section 5(1) and (2) of the FIA, and requested that "the scheme be placed under curatorship in terms of section 56 of the MS Act, read together with section 5(1) and (2) of the Protection of Funds Act". He added:

> "The basis upon which I seek the aforesaid relief is set out below. I seek the relief regarding curatorship as I hold the opinion in terms of the provisions of section 56(1) of the MS Act that the appointment of the curator is in the interest of the beneficiaries of the scheme and that it is desirable to do so, because material irregularities have come to my attention consequent upon an inspection of the scheme."

Section 56(1) of the MSA reads:

> "The Registrar may, notwithstanding the provisions of section 52 and 53, if he or she is of the opinion that it is in the interest of beneficiaries or that it is desirable to do so, because material irregularities have come to his or her notice, or because a medical scheme is not in sound financial condition, or as a result of an inspection of the affairs of the medical scheme, apply, with the concurrence of the Council, to the High Court, for the appointment of a curator to take control of and to manage the business of that medical scheme."

9. Section 52 and 53 of the MSA are concerned with judicial management and winding up and are of no application or consequence in the present matter. It is clear from the wording of section 56 that before the Registrar may apply for the appointment of a curator the following preconditions must exist:

a) he must be of the opinion that it is in the interest of beneficiaries; or

b) he must be of the opinion that it is desirable to do so because either:

   i) material irregularities have come to his notice, or

   ii) the medical scheme is not in sound financial condition; or

   iii) as a result of an inspection of the affairs of the medical scheme; and

c) the Council concurs in the Registrar's decision to apply to the High Court.

10. There is no dispute between the parties regarding the financial condition of the Scheme, which seems to be sound. The disagreement between them is about governance and fiduciary issues. The Registrar is of the opinion that it is desirable and in the interest of the beneficiaries to apply for the appointment of a curator because material irregularities have come to his notice as a result of the findings of an inspection of the affairs of the medical scheme.

11. Section 56(1) of the MSA notably does not specify the considerations which the court must take into account before deciding whether to grant the order. It differs in that respect from the FIA. Section 5(4) of the FIA permits the confirmation of the appointment of a curator, where a provisional curator has already been appointed (on good cause shown in terms of section 5(1) of the FIA) if the court is satisfied that it is desirable to do so. Since the enactment of the FIA in 2001, there is no similar provision in the MSA. That is so because the powers of the court in the MSA were formerly defined by way of the incorporation of the provisions of other legislation which have since been repealed. Section 56(2) of the

MSA makes the provisions of the Financial Institution (Investment of Funds) Act[3] applicable, insofar as they relate to the appointment of a curator in terms of that Act and insofar as they are not inconsistent with the MSA. The Financial Institutions (Investment of Funds) Act was repealed by section 11 of the FIA and no provision was enacted substituting the revoked incorporation by reference with a reference to the FIA. There is furthermore no provision in the FIA which provides that its provisions will apply *mutatis mutandis* to an application made in terms of section 56(1) of the MSA.

12. Notwithstanding these gaps in the legislation, it stands to reason that where an application is made in terms of section 56(1) of the MSA, the court, before granting it, should be satisfied that the Registrar's opinion regarding the interest of the beneficiaries and the desirability of the appointment of a curator is objectively supportable *inter alia* on grounds of apparent material irregularities or the findings of an inspection into the affairs of the medical scheme. While the opinion of the Registrar may be a subjective jurisdictional fact, the pre-condition does not confer an unfettered discretion. The Registrar under section 56(1) of the MSA is obliged to prove that his opinion is based on objective facts justifying the appointment of a curator on the grounds that it is desirable or in the interest of the beneficiaries to ensure that the problems identified regarding the management of the scheme will be addressed with beneficial consequences for those who have invested in it.

13. The Registrar is not confined to bringing an application for the appointment of a curator to take control of and to manage the business of a medical scheme in terms of section 56(1) of the MSA. As I mentioned earlier, if he prefers, he may do so in terms of the FIA. The failure to substitute the reference to the Financial Institutions (Investment of Funds)

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[3] Act 39 of 1984

Act and to incorporate the provisions of the FIA into section 56 of the MSA may make it preferable generally for the Registrar to seek the appointment of a curator in terms of section 5 of the FIA.

14. The definition of financial institution in the FIA includes "any medical scheme contemplated in section 1 of the Medical Schemes Act, 1998." Paragraph (c) of the definition of registrar in section 1 of the FIA includes "the registrar of medical schemes" except for the purpose of sections 6A-6I of the FIA, which provisions deal with other means of regulatory enforcement and sanction in respect of contraventions by financial institutions other than medical schemes. Section 5 of the FIA is nonetheless available to the Registrar as an effective mechanism of supervision and enforcement. Section 5(1) of the FIA provides:

> "The registrar may, on good cause shown, apply to a division of the High Court having jurisdiction for the appointment of a curator to take control of, and to manage the whole or any part of, the business of an institution."

Section 5 of the FIA is more complete than section 56(1) of the MSA and deals with a range of matters likely to arise in relation to the appointment of a curator. Thus, subsections (2) and (3) deal with the appointment of a provisional curator, while subsection (5) grants the court specific powers regarding the curatorship. Section 5(9) of the FIA provides that the court may on good cause shown cancel the appointment of the curator at any time.

15. The Registrar formulated the notice of motion and founding affidavit in this application with the requirements of section 56(1) of the MSA predominantly in mind. Counsel for the Scheme contended that the Registrar is accordingly restricted and can succeed only if the requirements of that section are met. If the requirements of section 56(1) of the MSA are met, then, as a rule, good cause (in the form of material

irregularities etc.) most likely will exist as well; meaning that there will be compliance with requirements of section 5 of the FIA. The reverse may however not be true. The good cause threshold may prove less exacting than proof of material irregularity etc. Counsel for the Registrar has argued in rebuttal that it would be unduly formalistic to deny the Registrar relief if he were to show good cause for the appointment of a curator simply on the grounds that the requirements of section 56(2) of the MSA have not been strictly established. I agree with that proposition. The interests of justice will be better served by construing the application as seeking relief in the alternative. A curator should be appointed if either the preconditions of section 56 of the MSA are established or good cause as contemplated in section 5 of the FIA is shown. Both statutes strive to protect members of the public invested in financial institutions in accordance with prudential social policy. In the context of the current global financial crisis, the regulator should be able to intervene where good cause exists to do so, without being constrained by technical, legalistic or formulaic objections. Besides, the Registrar in any event sought relief (in paragraph 8.1 of the founding affidavit) "in terms of section 56 of the MS Act read together with section 5(1) and (2) of the Protection of Funds Act"; he quite evidently made the application with both provisions in mind.

16. In *Executive Officer FSB v Dynamic Health Ltd and Others*,[4] ("*Dynamic Health*") the Supreme Court of Appeal ("the SCA") recently observed in relation to the requirement of good cause and the powers of the court under section 5 of the FIA as follows:

> "(4) The Registrar must therefore satisfy the court that there is good cause to appoint a curator. Reading ss(1) together with ss(4) that means that the court must be satisfied on the basis of the evidence placed before it that it is desirable to appoint a curator. Something is desirable if it is "worth having, or wishing for". The court must assess whether curatorship is

[4] 2012 (1) SA 453 (SCA)

required in order to address identified problems in the business of the financial institution. It assesses this in the light of the interests of actual or potential investors in the financial institution, or investors who have entrusted or may entrust the management of their investments to it. It must determine whether appointing a curator will address those problems and have beneficial consequences for investors. It must also consider whether there are preferable alternatives to resolve the problems. And ultimately what will constitute good cause in any particular case will depend upon the fact of that case....

(5) In the court below the respondents relied on the judgment in *Ex parte Executive Officer of the Financial Services Board: In re Joint Municipal Pension Fund*, where it was held the s5 "does not suggest a test which is more lenient than that set by the common law for the removal of trustees" and the court consequently applied in relation to s5(1) of the FI Act the approach to the removal of trustees laid down by this court in *Sackville West v Norse and Another.* That test is broadly whether the trustees have endangered the trust property by their acts or omissions or shown a want of honesty, fidelity or capacity to perform their duties. A lack of honesty or capacity on the part of the financial institution and those responsible for managing its affairs will ordinarily justify the appointment of curators to manage its business under s5(1) of the FI Act. To that extent it is correct to say that circumstances that warrant the removal of trustees of a trust, whether testamentary or *inter vivos*, would, if present in relation to a financial institution, ordinarily justify the grant of an order for the appointment of curators. However it by no means follows that the power of a court to make such an order is limited to that class of case....

(6) ... the inability or unwillingness of the institution to comply with regulatory requirements applicable to protected funds itself provides a reason for appointing a curator... When dealing with the investment of the funds of the public, where considerable hardship will be suffered by ordinary people if things go wrong, the Registrar cannot be expected to resolve factual disputes by litigation before obtaining an order appointing a curator. Provided the court is satisfied that the Registrar's concerns are

legitimate and that the appointment of a curator will assist in resolving those concerns, it will ordinarily be appropriate to grant an order.

The Registrar's directives of 20 December 2010

17. The Registrar's first concerns about the management and governance of the Scheme arose out of a series of interactions and correspondence with the Scheme that commenced during the course of 2010. His preliminary investigations led him to believe that the board was not acting in compliance with the legislative provisions regulating proper governance. As already stated, the Scheme is the fourth largest open medical scheme in the country. Its annual contribution income is in excess of R2,8 billion and it has reserves of approximately R1 billion. Being a registered medical scheme it is a public organization and one possessed of a substantial trust fund. As such, its trustees are bound to observe the utmost good faith and to exercise proper care and diligence with regard to the funds and property of the Scheme. They may not deal with or make use of the funds or property in a manner calculated to gain directly or indirectly any improper advantage for themselves, or for any other person, to the prejudice of the Scheme.[5] They are obliged furthermore to ensure that proper control systems are employed by or on behalf of the medical scheme; that adequate and appropriate information is communicated to the members regarding their rights, benefits, contributions and duties in terms of the rules; and that the rules, operation and administration of the medical scheme comply with the provisions of the MSA and all other applicable laws.[6] In addition, the board must take all reasonable steps to ensure that the interests of beneficiaries in terms of the rules of the medical scheme and the provisions of the Act are protected at all times,

[5] Section 2 of the FIA
[6] Section 57(4) of the MSA

and to avoid conflicts of interest;[7] it also must disclose annually in writing to the Registrar any payment or consideration made to the trustees.[8]

18. During the course of 2010 the Registrar formed the opinion that the board of the Scheme was falling short in these statutory duties in various ways. He proceeded then to address enquiries to the Scheme, which he is entitled to do in terms of section 43 of the MSA in relation to any matter connected with the business or transactions of the medical scheme.

19. The process of inquiry culminated on 22 December 2010 with a letter addressed to the board by Mr. Mmatli, the Council's Head of Compliance, in which the Council took issue with two service provider contracts which it considered to be tainted with illegality and not in the best interests of the beneficiaries of the Scheme.

20. The first contract brought into question was a "broker management agreement" between the Scheme and Medshield Brokers (Pty) Ltd. In the opinion of the Registrar, the Scheme's performance under the contract contravened different legislative provisions, most noticeably section 65 of the MSA, which regulates broker services and commission. The MSA defines a broker to mean a person whose business, or part thereof, entails providing a service or advice in respect of the introduction of prospective members to a medical scheme.[9] Section 65 of the MSA permits a medical scheme to compensate a broker, in accordance with its rules, for the introduction or admission of a member to that medical scheme, and grants the Minister the power to prescribe the amount of the compensation which a medical scheme may compensate any broker.[10] No person, other than a medical scheme, may directly or indirectly compensate a broker for the

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[7] Section 57(6) of the MSA
[8] Section 57(8) of the MSA
[9] Section 1 of the MSA
[10] Section 65(1) and (2) of the MSA

introduction or admission of members to a medical scheme.[11] And, equally, no broker may be compensated for providing services relating to the introduction or admission of a member to a medical scheme unless the Council has granted accreditation to such person.[12] And, lastly, a medical scheme may not directly or indirectly compensate a broker other than in terms of the section.[13] The overall purpose of section 65 of the MSA is to ensure first that only accredited brokers are involved in soliciting members for schemes, and, secondly, in the interests of control and minimising the costs (by excluding intermediaries), the agency relationship should be between the scheme and the broker directly.

21. The Council's letter of 22 December 2010 and the founding affidavit are vague and imprecise about the objectionable aspects of the impugned broker management agreement. Reference is made to previous correspondence, which unfortunately does not form part of the record. The Council's misgivings appear, nevertheless, to have been legitimate. It is not disputed that the arrangement led to payments to unaccredited brokers and the overpayment of VAT. The Council was particularly concerned about the effect that the chosen *modus operandi* had on the Scheme. The essence of the perceived regulatory failure is captured in the following paragraph of the letter:

> "It cannot be ignored that the practice gave rise to the Scheme having paid substantial amounts as fruitless expenses and without legal basis in respect of broker services to Medshield Brokers which were either retained by the latter entity and/or paid unlawfully to unaccredited individuals under the auspices of legitimate broker fees. It furthermore gave rise to the fact that the Scheme had no control over sub-brokers, their conduct and movement by clients by and between these subcontracted parties as the Scheme relinquished such controls in favour of Medshield Brokers who were responsible for managing these

[11] Section 65(6) of the MSA
[12] Section 65(3) of the MSA
[13] Section 65(5) of the MSA

> relationships. This practice would not have occurred if and to the extent that the Scheme managed all broker contracts had they been concluded directly with the Scheme."

22. The Council remonstrated further that there had been no or little effort on the part of the Scheme to address the Council's concerns or to manage the problem appropriately. It accordingly directed the Scheme to cancel the agreement with immediate effect and to contract directly with all accredited brokers in line with the MSA. It simultaneously instructed the Scheme to recover all unlawful payments, whether for VAT or to unaccredited brokers, from Medshield Brokers (Pty) Ltd.

23. The letter did not identify the statutory provision granting the Council or the Registrar the authority to issue the directives. The source of the Registrar's power to issue directives of this kind was a matter of some discussion in argument and is of importance not only in regard to the directives of 22 December 2010 but also in relation to other directives issued later.

24. The only provision of the MSA possibly authorizing such directives is section 44, which deals in general with inspections into suspected irregularities and non-compliance, or for the purposes of routine monitoring of compliance, and grants the Registrar the power to issue directives to deal with any regulatory issues arising in specified circumstances. The relevant provision is section 44(9)(a) of the MSA, which reads:

> "The Registrar may, if he or she is, on account of an inspection or investigation in terms of this Act or on account of any report, document, statement or information furnished to him or her under this section, of the opinion that a medical scheme is or may be rendered not financially sound –

> (a) by notice in writing direct the medical scheme to take such steps as may be specified in the notice which are, in the opinion of the Registrar, necessary –
>
> (i) to ensure the financial soundness of the medical scheme; or
>
> (ii) in the interests of the members of the medical scheme…"

Section 44(10) permits the Registrar, for the purposes of paragraph (a) of subsection (8), *inter alia*, to direct the medical scheme to conduct the business of the medical scheme "in a manner determined by the Registrar". As there is no paragraph (a) of subsection (8), the intended reference is evidently paragraph (a) of subsection (9).

25. No inspection had been conducted at the time the directives of 22 December 2010 were issued. Even so, the power to issue directives arises not only in the course of inspections in terms of section 44 of the MSA, but may be resorted to where the Registrar has regulatory misgivings on account of an "investigation in terms of this Act". However, the power can be exercised only if the Registrar holds the opinion that the scheme is or may be rendered not financially sound. While the Registrar in this case was apprehensive about financial prejudice to the beneficiaries of the Scheme, it is common cause that the Scheme was in no danger of being rendered financially unsound. For that reason, it is doubtful whether he had the authority to issue the directives under section 44 of the MSA.

26. Counsel for the Registrar, conscious of the fact that no power to issue the directives can be located in the MSA, submitted that the relevant power to issue the directives of 22 December 2010, and other directives that were issued later, is found in section 6(2)(a)(iii) of the FIA. It provides:

> "(2) For the purpose of ensuring compliance with a law, or if the registrar has reason to believe that an institution is contravening or failing to comply

> with, or has contravened or failed to comply with, any provision of a law, the registrar may –
>
> (a) by notice direct that institution to –
>
> (i) ....
>
> (ii) .....
>
> (iii) make arrangements to the satisfaction of the registrar for the discharge of all or any part of that institution's obligations in terms of such law."

27. Section 1 of the FIA defines "law" for the purpose of section 6 to include the MSA. The power of the Registrar to direct a medical scheme to make arrangements to his satisfaction for the discharge of its legal obligations under the MSA, in my opinion, would thus include a power to direct a scheme to rescind an illegal agreement and recover amounts paid to third parties illegally. Failing compliance with the Registrar's directive, the Registrar may institute proceedings in the High Court to compel the scheme "to comply with a lawful request, directive or instruction made, issued or given by the registrar under a law."[14]

28. In its written response to the Council's letter of 22 December 2010, dated 14 January 2011, the Scheme indicated its willingness to abide the directives in relation to the broker management agreement between it and Medshield Brokers (Pty) Ltd. It recorded that the Scheme had commenced entering into direct broker agreements with accredited brokers with effect from 1 October 2010 and agreed in future to make direct payment to brokers. It also gave an undertaking to recover the illegal payments. The amount of these illegal payments has not been stated in the papers and there is no evidence confirming that they in fact have been recovered.

[14] Section 6(1)(c) of the FIA

29. The second service provider contract which troubled the Registrar, in respect of which he issued other directives, and which is of greater consequence, was an agreement between the Scheme and Traffic Integrated Marketing CC ("TIM"). The contract provided for integrated advertising and marketing in the form of business strategy, public relations, media, research and the like. The contentious feature of the contractual arrangements was the payment of "research fees" by the Scheme via TIM, through a second entity, Medshield Distribution Services (Pty) Ltd ("MDS"), to brokers. The research fees were ostensibly consideration to brokers for research performed by them on new members. TIM did not have direct access to brokers and accordingly contracted MDS to use its network of brokers to collect the research data. The Scheme did not pay the brokers. It paid TIM who paid MDS, who in turn paid the brokers. The Scheme maintained that the purpose of the research was to assist it design options for private members, aimed at gaining a competitive edge over other schemes. According to an inspection report, commissioned by the Registrar in terms of section 44 of the MSA in November 2011, ("the Mahlangu Report"), the purpose of the research was questionable and no notable benefit accrued to the Scheme from it.

30. The Registrar is of the opinion that the payments were simply a ruse to pay brokers more than their prescribed limited fees in order to motivate them to sign up younger members with a more favourable risk profile. It is common cause that the research fee was paid to brokers only in respect of members aged 42 years and younger who completed research forms on admission to the scheme. Brokers were thus incentivised to approach potential members younger than 42 and would receive commission and the bonus of a research fee in respect of those admitted to the Scheme. The Registrar regarded the arrangement as age discrimination in violation of section 29(1)(n) of the MSA which requires the rules of a scheme to

make provision for non-discriminatory terms and conditions of admission to membership of a scheme.

31. Above all, the payment of research fees contravened the provisions regulating broker compensation. Section 65(2) of the MSA, it will be recalled, grants the Minister the power to prescribe the amount of compensation payable by schemes to brokers. The prescribed amount is the lesser of R65 plus VAT or 3% of premiums plus VAT.[15] The payment of research fees resulted in brokers receiving between R400 and R850 per member in addition to the permissible maximum of R65. According to the Mahlangu Report, the total amount paid in research fees was approximately R28 million, which the Registrar regarded as not inconsiderable wasteful expenditure.

32. In view of the fact that the arrangement contravened section 65 of the MSA, the Registrar directed the Scheme to cancel the TIM agreement and to recover all payments made as research fees for brokers. Additionally, seeing as the research fee payments were facilitated by MDS, and the Scheme was contemplating the acquisition of the business of MDS, he instructed the Scheme to undertake such acquisition process forthwith in order to terminate the relationship with MDS. The Scheme had appointed MDS to provide office facilities and the right of use of certain products related to broker management and distribution services like procuring membership applications, broker management and payment, the evaluation and design of scheme options, member retention, product development and marketing.

33. The Registrar further advised the Scheme that he would appoint an "independent compliance officer" at the expense of the Scheme to monitor

[15] In terms of Regulation 28(2) of the Regulations promulgated under the MSA, read with GN 1134 in GG 32771 of 3 December 2009 and GNR 1228 of GG32838 of 31 December 2009.

implementation of the directives and general compliance with the Act and rules until satisfied that such was no longer necessary. He again did not specify the provision of the MSA upon which he relied to appoint such a compliance officer. The only provision in terms of which he could have acted, it seems to me, is section 44(4)(b) of the MSA which provides that the Registrar may order an inspection for purposes of routine monitoring of compliance with the Act by the medical scheme.

34. And finally, the Registrar declared that he intended to impose a penalty for paying the research fees in contravention of the Act. He understood he was permitted to do so in terms of section 66(3) of the MSA and proposed to fine the trustees and the principal officer an amount of R1000 per day for each day the contravention continued. Calculated from 1 January 2008, the date the TIM agreement was concluded, the penalty, had it been collected, which it was not, would have amounted to more than R1 million. He invited the trustees to make submissions showing cause why such penalty should not be imposed.

35. The penalty, as I have just intimated, was not in fact imposed or collected at the end of the day. Nevertheless, the Scheme was justified in its ensuing criticism that the Registrar had misconstrued his powers in this regard. Section 66(3) of the MSA reads:

> "Any person who fails to furnish the Council or the Registrar with a return, information, financial statement, document or a reply to an enquiry addressed to him or her, as provided for by this Act or any directive under this Act, within the prescribed or specified period or any extension thereof, shall irrespectively of any criminal proceedings instituted under this Act, be liable to a penalty as prescribed for every day which the failure continues, unless the Registrar, for good cause shown, waives the penalty or any part thereof.

There is an apparent *casus omissus* in the provision. The words, "to comply with" should be inserted before the words "any directive under this Act". Neither the trustees nor the principal officer failed to furnish information, nor did they fail to comply with any directive issued under the MSA when paying the research fees. They may well have contravened section 65 of the MSA, but that would not permit the imposition of a penalty under section 66(3). Moreover, the directives issued in the letter of 22 December 2010, for the reasons already explained, were not issued under the MSA, but under the FIA. And even had it been possible to issue the directive under the MSA, the penalty then could only have been levied from the day upon which non-compliance with the directive commenced and not from the date of the commencement of the contract with TIM. Hence, the Scheme was correct to say, in its letter of 14 January 2011, that section 66(3) of the MSA could not apply in the circumstances.

36. The Scheme set out its position regarding the research fees and the TIM contract in its letters of 14 January 2011 and 4 February 2011. It accepted, without conceding, that the illegal payment of increased remuneration to trustees was a regulatory issue. It pointed out though that the research provided for in the agreement was no longer being pursued. However, it was reluctant to terminate the contract because TIM had other obligations to provide different services and cancellation of the agreement in totality would result in a large expense to the Scheme and a risk of loss of members. For those reasons, to all intents and purposes, it refused to comply with the directive. On top of that, it took the view that it had little or no prospect of successfully recovering the research fees from TIM, because TIM was unaware of any illegality and the Scheme would be unjustifiably enriched by retaining the benefit of the services for which the research fees had been paid. It concluded:

> "Should you nonetheless persist with your directive to recover monies paid in this regard, the Scheme would require your assurance that in the event that litigation is commenced and the Scheme is unsuccessful, your office will not complain that the Scheme embarked on speculative and fruitless litigation ..."

37. In its letter of 4 February 2011 the Scheme indicated that it did not propose to proceed with the acquisition of MDS, but did not elaborate in detail on why it was no longer inclined to do so.

The Ernst and Young compliance inspection

38. In its letter of 14 January 2011 the Scheme recorded that it was not opposed to the Council appointing a compliance officer, to the extent that it was legally competent to do so. It offered its full co-operation and proposed that someone from a prominent auditing firm be appointed and that his functions be clearly defined. Mmatli replied to this in a letter dated 21 January 2011 indicating that the Council would appoint Adv James de Villiers of the firm Ernst and Young in terms of section 44(4)(b) of the MSA for the purposes of monitoring the Scheme's compliance with the Act and the directives issued. He annexed a copy of the proposed terms of reference, which called for an investigation of the broker management arrangements, the recovery of illegally paid amounts, and the TIM and MDS contracts. The terms further required the inspector "to ascertain and report on the general governance of the Scheme"; and "to ascertain and report on any matter of non-compliance with regard to any of the abovementioned issues and/or entities".

39. In its letter dated 4 February 2011, the Scheme objected to the scope of the terms of reference on the ground that it had agreed to the appointment of a compliance officer to monitor implementation of the directives and compliance with the Act and not to a wide-ranging inspection. It complained that the proposed enquiry suggested an investigative function

beyond a compliance inspection in terms of section 44(4)(b) of the MSA. In so far as it unexpectedly appeared that an investigation into the affairs of the Scheme was to be conducted in terms of section 44(4)(a) of the MSA, it denied having agreed to that.[16]

40. The Registrar formally appointed Adv de Villiers as an inspector in terms of section 44(4)(b) of the MSA on 9 February 2011. The trustees of the Scheme objected to the appointment and reiterated their opposition in a letter dated 11 February 2011. They contended for a second time that the appointment and terms of reference were not in accordance with their understanding or agreement about what the compliance officer would do. They asserted also that there was no reason to carry out an inspection as all the issues had already been addressed. They accordingly requested the inspection to be suspended.

41. The stance adopted by the Scheme led to more meetings between it and the Registrar and lengthy correspondence re-canvassing many of the issues. The Scheme steadfastly objected to the inspector's terms of reference. Later, it impugned the independence of Adv. de Villiers and Adv. Lubbe, a senior investigator with the Council, on the grounds that they in the past had accused the Scheme of various criminal offences, including money laundering. The Scheme protested in a letter dated 11 April 2011 that it was most aggrieved by the Registrar "insisting on the powers of the inspectors, to which the Scheme has not agreed". The grievance is noteworthy by reason of the Scheme's misplaced supposition that it was at liberty to set the terms of reference of a regulatory and compliance inspection into its affairs.

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[16] Section 44(4)(a) permits the Registrar to order an inspection "if he or she is of the opinion that such an inspection will provide evidence of any irregularity or of non-compliance with this Act by any person".

42. Ernst and Young issued an inspection report on 11 April 2011. The report made several significant allegations against the chairperson of the board of trustees, Mr. T. Mabeta, to the effect that he had obstructed the inspection and made it impossible for the inspector to perform his tasks and fulfil his mandate. Mabeta declined *inter alia* to supply information regarding meeting dates and financial records to Ernst and Young, supposedly because "it did not have the authority to request such information or documentation". He refused the inspector permission to interview employees of the scheme, instructed the principal officer not to provide information to the staff of the inspector and made it clear that they were not welcome on the Scheme's premises. In the result, the inspector was not able to determine whether or not the Scheme had complied with the directives and was adhering to the MSA. None of these allegations in the founding affidavit have been denied by the Scheme and may accordingly be deemed to be admitted.

43. After considering the Ernst and Young report, the Registrar addressed a letter dated 2 June 2011 to Mabeta in his capacity as chairperson of the board of trustees. He observed that Mabeta had reneged on an undertaking to cooperate with the inspection by refusing the inspectors access to the premises and records of the Scheme, and pointed out that the issues giving rise to and forming the subject of the inspection were of a serious nature requiring urgent investigation without further delay. The Registrar called upon the board of trustees to agree within 5 days that the inspection would be allowed to proceed unconditionally and without further obstruction, failing which he would urge the Council to implement steps for the removal of the trustees in terms of section 46 of the MSA.[17]

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[17] Section 46 of the MSA permits the Council to remove a trustee from office if it has sufficient reason to believe that the person concerned is not a fit and proper person to hold office.

The intervention of the Chairperson of the Health Portfolio Committee of Parliament

44. In reaction to this letter, Mabeta, the next day, addressed a letter on behalf of the board of trustees to the Chairperson of the Health Portfolio Committee of the National Parliament, Dr. Goqwana, requesting his intercession, alleging amongst other things that the Council had "entrapped the Scheme with a forensic investigation when there may be a motive to prosecute the Scheme" and a "clear abuse of power and unfair treatment". Dr. Goqwana agreed to intervene. The wisdom of such an intervention is debatable, as borne out by subsequent criticism of Dr. Goqwana in the media alleging unseemly political interference in the affairs of an independent regulator.

45. Dr. Goqwana convened a meeting on 22 June 2011 which was attended by members of the Council, the Registrar and representatives of the Scheme. The meeting agreed that another inspector would be appointed, that the Scheme would co-operate with a continued inspection and the matter would be referred back to the Council for deliberation.

46. Following the meeting, Mabeta addressed a letter, dated 27 June 2011, to the Registrar. In it he said:

> "In accordance with Dr Goqwana's directive, we have considered the terms of reference of the section 43 enquiry issued against the Scheme and suggest, as a first step in the process, that we agree on an independent and capable compliance officer. In this regard, it would make sense for you to propose three suitable candidates."

The point of view is troubling. Apart from the insinuation that the Registrar and the Council were subject to the directive of a politician in the performance of their functions, Mabeta was perceptibly strengthened in

his misguided presumption that the Scheme had the right to negotiate the terms of reference of the inspection and select a preferred inspector. His standpoint miscomprehended the requirements of the MSA and lacked insight into the possibility that the Scheme's posturing risked a charge of impropriety. In line with his way of thinking, Mabeta concluded the letter with a pronouncement that the compliance officer "will be responsible" for monitoring four issues as formulated by him (related to the research fees and broker commission) and that the inspection would be restricted to such. Once more, to repeat, the Scheme's point of view is objectionable and rests on the ill-advised supposition that it was free to dictate the terms of reference of any inspection.

47. The Registrar responded in an email dated 29 June 2011. The tone of the email was conciliatory, but the Registrar declared plainly that he was not prepared to fetter his discretion in carrying out his duties and functions in terms of the MSA. He said:

> "The Terms of Reference (TOR) will emphasise on (sic) Monitoring Compliance and Inspection as envisaged in terms of the Medical Schemes Act, and NOT an investigation as was contested (sic) during the meeting on 22 June 2011. As a regulator the position of the CMS may change in this regard should evidence of fraud, pyramid scheme and money laundering become available since we view such seriously, warranting a full scale investigation to be conducted."

In effect, the Registrar pointed out (correctly) that the terms of reference of an inspector in terms of section 44(4)(b) of the MSA fell within his discretion, which he was obliged to exercise properly, free of dictation and interference; and that if evidence came to light of serious irregularity he would be obliged to pursue an investigation in terms of section 44(4)(a) of the MSA.

48. Further correspondence was exchanged and another meeting was held on 20 July 2011 in which the Registrar again declined to limit the terms of reference of the inspection to those preferred by the Scheme.

49. When the conflict failed to resolve, Dr. Goqwana addressed a letter dated 11 October 2011 to Prof. Pick, the Chairperson of the Council, in which he sided with the Scheme and expressed his disappointment at what he perceived to be bad faith on the part of the Council. He opined:

> "We cannot have the regulator continuing to embark on a collision course with own stake holders (sic) and in the process, destabilizing the industry and hope for the Department and Parliament to implement NHI (National Health Insurance) successfully."

The letter continued with an implicit warning that the budget of the Council might be impacted negatively if the Council were to maintain its position. After predicting the likelihood of litigation, Dr. Goqwana observed:

> "Parliament is already concerned about the CMS budget which reflects larger sums of it allocated towards escalating legal fees. It is thus not surprising that the legal budget has increased from R3 million to R8 million in three years. We think this can be managed better."

He ended by expressing a preference for the matter to be resolved "amicably and expeditiously, without any legal wrangles and legal people".

50. Reports appeared thereafter in the media criticising Dr. Goqwana for meddling in the running of the Council and seeking to prevent an investigation into alleged corruption by the trustees of the Scheme. In a letter dated 1 November 2011, addressed to Prof. Pick, Mabeta called upon the Council to respond to the media reports and "to clarify the position, vindicate the hard work of Dr. Goqwana and distance itself from the media release which merely has the effect of sowing disharmony in

the medical schemes industry". It is not clear whether the Council obliged. I assume it did not.

51. Dr. Goqwana's comment about the escalating legal budget, although possibly in line with his oversight role in Parliament, is open to question. A line item of R8 million for legal fees in the budget of a regulator with supervisory authority over an industry possessed of more than R100 billion of investor assets is not excessive. In my opinion, it is worryingly modest. Supervision and enforcement by means of litigation are central elements of the regulatory system. Both the MSA and the FIA oblige the Council and the Registrar to resort to the courts in a number of instances. To expect regulation to be managed, in the words of Dr. Goqwana, "amicably" and "without any legal wrangles" is, with respect, naïve, misplaced and, in the current economic climate, positively dangerous. Regulators of financial institutions throughout the world have been criticized for failing to resort to precautionary litigation in the run up to the global financial crisis, often because they lacked funds to do so. Just as disconcerting is the fact that Dr. Goqwana raised the issue with the Council in response to a letter addressed to him by the Scheme dated 11 October 2011 in which Mabeta said:

> "We need to draw your attention to CMS legal budget which has had to be increased from R3 million to R8 million in three years. We believe that this is exorbitant and underscores the litigious nature of certain officials within CMS."

This may be reasonably construed as a calculated attempt to restrict the resources of the regulator in the hope of weakening its capacity for intervention. It is to be regretted, given his office, that Dr. Goqwana was willing to be influenced by it.

The inspection in terms of section 44(4)(a) of the MSA

52. In view of the lack of progress, the Registrar decided to terminate the inspection in terms of section 44(4)(b) of the MSA, and having reached the opinion that an inspection would provide evidence of irregularity and non-compliance with the MSA, he ordered an inspection in terms of section 44(4)(a) of the MSA and appointed Mr. Jabu Mahlangu as an inspector for that purpose. The terms of reference reveal that the Registrar contemplated an extensive inspection of the affairs of the Scheme, taking account of its relationship with Medshield Brokers (Pty) Ltd, MDS and TIM. The focal points of the enquiry were to be any conflicts of interest by the trustees; payments made to trustees, their family members and entities with which they were associated; payments made to staff; all agreements with and payments made to service providers and prospective service providers of the Scheme; all steps taken by the Scheme to recover unlawful payments made to TIM, Medshield Brokers (Pty) Ltd and any broker of the Scheme; and other aspects of the Scheme's affairs.

53. Immediately upon the appointment of Mahlangu, the attorney of the Scheme addressed a comprehensive letter dated 4 November 2011 to the Registrar challenging the decision to order an inspection and appoint an inspector. He contended that the decisions taken by the Registrar constituted administrative actions which were unlawful by reason of the fact that they were both unreasonable and procedurally unfair. He therefore requested the Council to furnish written reasons as to why the inspection in terms of section 44(4)(b) of the MSA was terminated, and why it was decided to institute an inspection in terms of section 44(4)(a) of the MSA. He sought particulars also of any alleged irregularity and non-compliance and the evidence of such expected to be obtained from the Scheme during the course of an inspection. He indicated that on receipt thereof he would advise the Scheme on whether to institute proceedings

by way of judicial review. He finished with an ultimatum requiring an undertaking that the inspection would not commence until such time as the receipt of reasons. Failing which, the Scheme would consider obtaining an urgent interdict.

54. The Registrar responded by letter dated 15 November 2011, in which he stated his opinion that a decision to launch an inspection in terms of section 44(4)(a) of the MSA does not constitute administrative action in terms of the Promotion of Administrative Justice Act[18] ("PAJA"). For that reason he did not consider that he was compelled by law to furnish the Scheme with reasons in terms of section 5 of PAJA. Regarding the Scheme's belief that it was entitled to negotiate and agree upon the terms of an inspection, the Registrar explained:

> "The scheme expects this office to agree on terms of reference and threatens with litigation should it not "adopt a suitable attitude". However, to undertake an inspection only on the basis of agreed terms of reference would fetter my duty to act in the best interests of the scheme's beneficiaries."

He further justified his stance as follows:

> "The trustees occupy a very public office, namely managing the scheme in the best interests of more than 200 000 beneficiaries. The scheme has large amounts received from its members under its control. Accordingly the scheme operates in a regulated environment and the inspection is called for in order to ensure the effective regulation of the Scheme. The scheme and the other entities to be inspected have no reason to fear that Mr. Mahlangu will not report objectively and impartially on the affairs of the scheme and other entities."

55. The Scheme did not pursue its threats to litigate and Mahlangu proceeded with the inspection in terms of section 44(4)(a) of the MSA.

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[18] Act 3 of 2000

56. While the inspection was in progress, an issue arose regarding the contract with MDS. In December 2011 Mahlangu informed the Scheme that he believed the continuation of the contract with MDS would constitute disregard of the directive of 22 December 2010 that the contract with MDS be terminated. The Scheme's attorney wrote to the Registrar on 17 January 2012 informing him that no such directive had been issued. Strictly speaking he was right. Although the attorney did not state as much, the original directive had directed the Scheme to initiate the process of acquiring the business of MDS. In his letter of 17 January 2012, the attorney advised the Registrar that the Scheme in any event had contracted with Sapling Trade and Invest 41 (Pty) Ltd ("Sapling") who was the new owner of the business of MDS. It later transpired that the CEO of MDS, Mr. J le Roux, was also the CEO of Sapling. The Scheme contended that:

> "... there is no CMS directive that either did preclude or lawfully could have precluded our client from continuing with a contract in respect of the services offered by MDS. In any event, as indicated above, there has not been any renewal of the MDS contract but a conclusion of a new contract in respect of the business of MDS with its new owner Sapling ...."

The letter dealt with other matters and concluded that the Scheme had a right to be afforded an opportunity to make representations in the contents of any report that might be prepared by Mahlangu before the report was finalised.

52. The contract with Sapling has assumed significance in these proceedings. As will appear more fully later, Mahlangu thought that the contract involved a duplication of services and was not beneficial to the members. The Scheme initially had an agreement for distribution services with an entity called iChoices (Pty) Ltd ("iChoices") which later became MDS. In terms of the agreement, the Scheme appointed MDS to provide office

facilities, and the right of use of certain products. It also rendered services in respect of broker management, regional support, scheme requirements and reporting. MDS provided offices throughout the country provisioned with information and communication technology. The distribution services encompassed procuring membership applications, broker management and payment, the evaluation and design of scheme options, member retention, product development and marketing. It was these functions that Sapling took over with effect from 1 January 2012 while the inspection was in progress.

58. Mahlangu brought out his first inspection report, dealing with the period 1 January 2008 to 2 November 2011, on 9 May 2012. After receipt of the first report, the Registrar extended the inspection period from 2 November 2011 to 13 June 2012 which resulted in a second report being produced on 14 August 2012. The first report consists of 242 pages and 153 annexures consisting of thousands of un-paginated pages contained in 7 lever arch files, while the supplementary report consists of 75 pages with 33 annexures consisting of more than a thousand un-paginated pages contained in 3 lever arch files. Frankly, the reports are poorly structured and lack the measure of coherence one might have expected. The Registrar in his founding affidavit has not attempted an analysis of the investigation and its findings, but has confined himself to selected issues lying behind the directives he issued on 15 June 2012 consequent upon his perusal of the report. This has goaded the Scheme to complain, not unreasonably, that the Registrar has failed to sensibly identify the exact parts of the report on which he relied in support of the action he took. Be that as it may, the report irrefutably raises concerns which the Registrar says are legitimate, justifying the action he took. He maintains that he ought not to be expected to resolve factual disputes by litigation before obtaining an order appointing a curator.[19]

[19] *Executive Officer FSB v Dynamic Health Ltd and Others supra* note 4 at para 6.

The Registrar's directives of 15 June 2012

59. Following on the first inspection report, the Registrar issued fresh directives on 15 June 2012 in a letter of that date which reads:

> "1. As Medshield Medical Scheme ("the scheme") is aware, I ordered an inspection in terms of Section 44(4)(a) Medical Schemes Act, 131 of 1998, ("the Act") and section 2 of the Inspection of Financial Institutions Act, No 80 of 1998 ("the Inspection of Financial Institutions Act") into the affairs of the scheme on 2 November 2011. Mr. Jabu Mahlangu of Ligwa Advisory Services ("Ligwa") was appointed to conduct the inspection.
>
> 2. As a result of the inspection certain information has come to my attention, indicating non-compliance with the law applicable to medical schemes. In order to ensure compliance with the law and in the best interests of the scheme's beneficiaries, I hereby direct the scheme to take the following steps:
>
> 2.1 To terminate the contractual relationship between Sapling Trade and Invest 41 (Pty) Ltd, which contract replaced the previous contract with Medshield Distribution Services (Pty) Ltd;
>
> 2.2 To terminate the contract with Inkwazi Debt Solutions CC in which Mr. Mabeta, chairperson of the scheme, has/had a material interest;
>
> 2.3 To recover all payments made to the Chairperson, Mr. Mabeta, for occupying the position of Chief Executive Officer during the months of September and October 2011;
>
> 2.4 To recover the amount of R187 222-15 paid to Mr. Clive Stuart for acting as Executive Principal Officer from October 2009 to December 2009;
>
> 2.5 To recover the amount of R27 666 500-18 plus interest paid for "research fees" from Traffic Integrated Marketing CC, Medshield Distribution Services and/or any brokers to whom such payments were made;

2.6 To recover the amount of R56 361-52 plus interest from the scheme's employee, Melani Coetzee, who received such payment purportedly authorized in favour of Keystone Concepts;

2.7 To recover the amounts paid as "retainer fees" to all trustees/entities appointed by the trustees for purposes of receiving payment, over the period 2008 to date;

2.8 To recover all payments made as consultancy fees to members of the board of trustees of the scheme/entities appointed by the trustees for purposes of receiving payment, over the period 2008 to date;

2.9 To recover all VAT payments to brokers who were not registered for VAT over the period 2008 to date.

The scheme is hereby directed to report to this Office the steps they have taken and/or intend to take regarding the above directives by no later than 16:00 on Friday 13 July 2012."

The Scheme's appeal in terms of section 49(1) of the MSA

60. The Scheme, through its attorneys, filed a notice of appeal, in terms of section 49(1) of the MSA, appealing to the Council against the decision of the Registrar to issue the directives. Section 49(1) provides that any person who is aggrieved by any decision of the Registrar under a power conferred or a duty imposed upon him by or under the MSA, excluding a decision that has been made with the concurrence of the Council, may appeal against the decision to the Council within 30 days. The Scheme's notice of appeal included twelve grounds of appeal alleging, inter alia, that the Registrar acted procedurally unfairly and unlawfully in issuing the directives; that there was no proper basis (on various grounds) for the issuing of each individual directive; and that the directives were unlawful because they were issued pursuant to an unlawful inspection.

61. It is common cause that the Council took no steps to process the appeal before the Registrar brought the *ex parte* application for the appointment

of a provisional curator. In the opposing affidavit the Scheme contended that the application for the appointment of a provisional curator was premature because the decision to issue the directives was the subject of an appeal. The Scheme relied on section 49(2) of the MSA, which provides that the operation of any decision which is the subject of an appeal under section 49(1) of the MSA shall be suspended pending the decision of the Council, and accordingly it assumed, legitimately in my view, that it was under no obligation to comply with the directives while the appeal remained in progress. It contended that the Registrar's decision to launch the application for the appointment of a curator in the face of the appeal was an illustration of his subjectivity and an iniquitous prejudging of the trustees' challenge to his directives.

62. The Registrar explained his stance and the reasons for it in the replying affidavit. All the directives pertained to the recovery of money allegedly unlawfully disbursed and the termination of contracts of questionable value to the beneficiaries of the Scheme. He chose therefore to issue the directives in terms of section 6(2) of the FIA, because he had reason to believe that the Scheme had failed to comply with the law in that its board of trustees were not ensuring that the interests of the beneficiaries were protected, had not acted in good faith and had not taken all reasonable steps to avoid conflicts of interest. Hence, because he had issued the directives under the FIA, he did not make a decision under a power conferred upon him by the MSA, meaning that the section 49(1) appeal provisions were not applicable. The remedy available to a party aggrieved by a decision taken under section 6(2) of the FIA is judicial review in terms of Rule 53 of the High Court Rules.

63. The Registrar argued additionally that even had section 49 been applicable that would not have precluded him from seeking the appointment of a curator. The appeal process could take years to

complete since a decision of the Council under section 49 of the MSA is appealable to the Appeal Board established by section 50 of the MSA, which decision in turn would be reviewable before the ordinary courts. It could not have been the intention of the legislature, he submitted, to allow ongoing irregularity and possible misuse of funds to continue, and the appointment of a curator to be delayed, while issues were taken through a protracted appeal and review process. The appointment of a curator invariably will be attended by exigencies justifying direct intervention by the courts.

64. While I accept the merit of the Registrar's submissions, his conduct is not beyond criticism. In none of the correspondence did he ever communicate that he was acting in terms of section 6 of the FIA. One may expect a transparent, accountable and responsive regulator to play fairly by informing a scheme which has embarked on the wrong course of action of the correct route to follow in regard to its adverse decisions. The Registrar's failure to have done so in this instance bears out the Scheme's contention that to some extent he may have lost a degree of objectivity.

65. Regardless of the virtue or otherwise of the stance taken, the fact remains, the Council did not process the appeal. Instead it met on 25 August 2012 and concurred with the Registrar's decision to bring a curatorship application. Its resolution is dated 30 August 2012 and is signed by the vice-chairperson. No explanation for the difference in dates has been offered, but I do not take such to mean that the resolution was not in fact taken, especially in view of the common cause facts that the Council met on 25 August 2012 and eight of its twelve members were present and took the decision. As already mentioned, the Registrar lodged the application for the appointment of a curator on 27 September 2012 and the rule *nisi* was issued by van der Merwe DJP on 2 October 2012.

The report of the provisional curator

66. Mr. Themba Langa, an attorney, was appointed as provisional curator in terms of the rule *nisi*. On 29 October 2012 he submitted a report to the Registrar in relation to the affairs of the Scheme in which he expressed an opinion that the election of the board of trustees on 28 June 2012, shortly after the Registrar had issued his directives, was "a sham, illegitimate and the outcome thereof must be disregarded as the trustees were beneficiaries of elaborate fraudulent and corrupt activities". On the evidence in his possession he considered that 75% of the total votes cast in the election were invalid. As he saw it, the alleged wrongdoing was in pursuance of an attempt by the service provider Sapling to gain control of the board of trustees to protect its interests in view of the Registrar's avowed intention in the directives to compel the termination of the relationship between the Scheme and Sapling.

67. The provisional curator reported in addition that Sapling was in effect funding the application of the trustees to intervene in this application by undertaking to indemnify the trustees in respect of any legal costs; which effectively means that a service provider that benefits from a contract with the Scheme, valued at R44 million per annum, the worth and propriety of which has been questioned by the regulator, is funding the opposition of the trustees to the application for a curator.

68. The trustees, through the deponent to the opposing affidavits, Mr. Francois Barnard, an attorney, who became a trustee only on 28 June 2012, admit that Sapling approached the trustees with a proposal to indemnify them and has given the undertaking. They consider their conduct as acceptable because they are not in a position to fund the opposition to the application personally. Their position suggests a lack the confidence that opposition to the application would be in the interest of the

beneficiaries to an extent justifying the Scheme incurring the legal costs of opposition. If the appointment of a curator is not in the interest of the beneficiaries, the trustees would be within their rights to use the funds of the Scheme to oppose the application. The trustees were apparently unsure about the merits of opposing the application. They were thus amenable to an approach by Mr. Le Roux, the CEO of Sapling, who, according to Barnard, "clearly has an interest in the future financial stability and well being" of the Scheme. They maintain that no consequent conflict of interest arose in relation to the award of the contract as it was concluded six months before the election and imply that any possible future conflict of interest, between their duty to oversee the Sapling contract and being beholden to Sapling by reason of the indemnity, can be managed as and if it arises.

69. The possible conflict of interest must be viewed in the context of the serious allegations made by the provisional curator that Sapling was instrumental in an irregular election aimed at Sapling gaining control of the board of trustees to advance its own interests rather than to protect the interests of the beneficiaries of the Scheme.

70. In terms of Rule 18.1.1 of the Scheme's rules the trustees of the Scheme shall be elected by the members of the Scheme from amongst its membership at an Annual General Meeting. The current board consists of ten trustees, five of whom (Singh, Mabeta, Griffin, Wright and Dawson) were first elected before 2012. The other five, (Holland, Barnard, van Wyk, Pieterse and Kriel), were elected for the first time at the AGM of 28 June 2012. These latter five the Registrar has referred to as "the Sapling trustees". For reasons that will become apparent, that designation is fitting, and hence I too will use it.

71. The Sapling trustees became members of the Scheme in circumstances viewed as suspicious by the provisional curator. All of the Sapling trustees became members of the Scheme on 1 June 2012, a mere four weeks before they were elected as trustees. They were all introduced to membership by the same broker, Ms. Marisa Groenewald. Four of the five Sapling trustees had belonged to other medical schemes for periods ranging from 11 to 23 years prior to their resigning and then joining the Scheme. The other, van Wyk, was a member of his previous scheme for 3 years. Members of medical schemes may not by law belong to more than one scheme. All of them, except van Wyk, did not register their dependants with the Scheme because it would have been disadvantageous to do so.

72. Only 38 members attended the AGM on 28 June 2012. The Sapling trustees received between 1166 and 1419 votes each and were elected by way of proxy. A total of 1396 proxies were recorded as meeting the requirements set by the Scheme; of these 1354 were held by four persons all of whom were associated with Sapling, namely Mr. Andile Nyeberu, a manager at Sapling; Ms Helen O' Dwyer, a regional manager of Sapling; Hughsherine Segels, an employee at Sapling; and Mr. Jan le Roux, the CEO of Sapling. These persons used their proxies to vote exclusively for the Sapling trustees, except Segels did not vote for Kriel. The five Sapling candidates for election all received more than 1000 votes, while the other non-Sapling, unsuccessful candidates who stood for election received less than 4 votes each. All the new trustees voted for each other and the chairperson of the board, Mabeta, used all his proxies to vote for the Sapling trustees.

73. It is reasonable to infer from this evidence that there was a plan by four persons associated with Sapling, and perhaps Mabeta, to use proxies to elect the five new members of the Scheme to the board. The provisional

curator concluded that Sapling had engaged in a concerted effort to gain control of the Scheme's board.

74. The Registrar, relying on the information conveyed to him by the provisional curator, maintains that many of the proxies were invalid and flawed, or were acquired and applied in suspicious circumstances. These irregularities, he believes, rendered the election illegitimate and probably illegal. Rule 27.2 requires all proxies to be sent to members of the Scheme together with the AGM invitation and must be in a form agreed by the Scheme's board of trustees. In terms of Rule 26.1.2 the AGM notice must contain the agenda and abridged financial statements and board report. The requirement that these documents should accompany the proxy is to enable members to make an informed decision before granting a proxy.

75. The AGM notices, with accompanying documentation, were dispatched to members during the period 23-31 May 2012. Many, if not most, of the proxies used to elect the Sapling trustees were dated and signed before 23 May 2012 and a considerable number were not in the form agreed by the board of trustees. Several did not indicate the date of the AGM for which the proxy was given. They also did not indicate the date before the AGM by when the proxies had to be returned. It would seem therefore that the proxies used to elect the Sapling trustees were not sent with the AGM documentation. Furthermore, in some instances the font of the wording of the proxy differed from the board's approved proxy form and the name of the proxy holder on the form had been photocopied rather than written onto the form. Of the proxies used by Andile Nyebevu, for example, 757 differed materially from the proxy form approved and dispatched by the Scheme and were signed weeks before the AGM packs were sent to members. All of them were photocopies with Nyebevu's name written on an original and copies of this form then being made with his name inserted

before the form was copied and most importantly before the forms were signed by members.

76. The curator was unable to establish when the proxies not received electronically were in fact received by the Scheme. It was a requirement in terms of the dispatched form that the proxies be received by the Scheme no later than 25 June 2012. There is also no indication as to when the nomination forms were received by the Scheme and whether the nomination process was in accordance with the Rules.

77. The Registrar has labelled the election as "highly irregular and questionable". In view of the perceived irregularities, he submitted that trustees were not validly elected and cannot legitimately claim to represent the Scheme. Besides that, he is convinced that all the trustees have placed themselves in an indefensible, conflicted position by agreeing to Sapling funding the litigation when Sapling was obviously intent on protecting its own interests through the continuation of the service provider agreement which the Registrar considers not to be in the best interest of the beneficiaries.

78. As explained at the outset, the provisional curator's report and the information concerning the alleged irregular election and possible conflict of interest was obviously not available when the founding papers were drafted and the rule *nisi* was sought. The Registrar has urged that the desirability of an order appointing a curator be assessed at the time of the hearing of the application seeking confirmation of the rule *nisi* in the light of the information available about the current situation now prevailing. That seems to me to be the correct approach. The desirability of such an order must be assessed at this point in time, above all, in view of the situation having changed materially.[20] The trustees and the Scheme have

[20] *Executive Officer FSB v Dynamic Wealth Ltd and Others supra* note 4 at para 33, 38 and 43

had a proper opportunity to deal with the allegations and have done so comprehensively in the supplementary duplicating affidavit. I propose to deal with the merits of their response later when dealing with the Registrar's concerns about the Scheme's relationship with Sapling.

The Registrar's grounds for a final order appointing a curator

79. On the return day the Registrar rested his case for the desirability of appointing a curator on four distinct grounds, namely: the Scheme has consistently failed to comply with regulatory demands in respect of its contraventions of the MSA; the trustees have demonstrated a flagrant disregard of the provisions of the MSA and the rules of the Scheme; the irregular election of the board on 28 June 2012; and the fact that the relationship with Sapling has conflicted the trustees to such an extent that the governance of the Scheme by the trustees has become untenable.

80. I will proceed to examine each ground in turn.

The alleged failure or refusal of the Scheme to comply with regulatory demands.

81. The SCA held in *Dynamic Wealth*[21] that the inability or unwillingness of a financial institution to comply with regulatory requirements applicable to protected funds normally will provide a reason for appointing a curator.

82. The conduct of the Scheme which at first caused the Council concern and invited regulatory intervention was the illegal payment of fees to brokers. The contractual arrangements put in place by the Scheme led to illegal payments being made to unaccredited brokers and payments to them in excess of the statutory prescribed levels. From the Registrar's

[21] Note 4 *supra* at para 6

perspective, the contract for the payment of research fees was a ploy calculated to evade the preemptory provisions of the MSA and resulted in illegal wasteful expenditure amounting to R28 million to the detriment of the Scheme and its beneficiaries. Added to that, the so-called research added little of value to the Scheme and violated a fundamental tenet of the regulatory framework, namely the principle of non-discrimination. The conduct understandably gave rise to legitimate concerns about the governance of the Scheme and the ethical behaviour of those responsible for its management. At the very least, it revealed a lack of insight and poor judgment on the part of the trustees. The response of the trustees to the intervention was not encouraging. Initially they were reluctant to concede their wrongdoing, then, when it was indisputably obvious that the payments were illegal, sought to minimize the issue, and ever since the Registrar issued his directives, have consistently refused to take steps to recover the illegal payments. They have singularly neglected to make any effort to engage with those who benefited from the illegal payments, and have chosen not to heed the Registrar's directive. They rely instead upon a legal opinion that the amounts may not be recoverable.

83. The Scheme, furthermore, has offered no evidence justifying the "research" undertaken. It has not denied the Registrar's averment in the founding affidavit that the research was never used by the Scheme. All it has said is that the research has not been pursued and the results have not been used. Such is an implicit concession that the research was of minimal or no value to the Scheme. The fact that the "research" may have been of no value to the Scheme could affect the *quantum* in an enrichment action to recover the illegal payments and possibly may rebut any defence raised on the merits. Despite the duty of the trustees to act in the utmost good faith and to protect the interests of the beneficiaries, they remain headstrong that they prefer not to recover the R28 million paid illegally to the service providers.

84. The Scheme's attitude, predictably, contributed to the Registrar's decision to institute a compliance inspection in terms of section 44(4)(b) of the MSA. Counsel for the Scheme submitted that it sought throughout to resolve all regulatory concerns amicably and has used its best endeavours to respond to all enquiries. That is simply not true. The undisputed evidence shows that the chairperson of the board of trustees obstructed the access of the Ernst and Young inspectors to the premises and failed to furnish them with documentation and the opportunity to confer with employees of the Scheme. After that, he arrogantly insisted on the right to dictate the terms of reference of the inspection and to vet the identity and qualifications of the inspector. When it became clear that the Council and the Registrar would not back down and were intent upon a proper investigation of the manner in and purposes for which the board was expending the funds of the Scheme, the chairperson resorted to seeking political interference and came close to lobbying for a reduction in the Council's budget in the hope of limiting its capacity to litigate against it and other errant schemes. When all is considered, its submission that it has remained committed to avoiding confrontation with the Council and to maintain a meaningful and productive relationship with it, is lacking in substance, not borne out by the evidence and ultimately not credible.

85. The Scheme's refusal to submit to an inspection on terms other than those formulated by itself was obstructive and frustrated the initial inspection in an unacceptable fashion. While in the end the second inspection by Mahlangu, in terms of section 44(4)(a) of the MSA, was able to proceed, the Scheme's stance in relation to it was hardly inspiring of confidence or convincing that it sought to "maintain a meaningful and productive relationship". Instead of yielding to an inspection of its affairs, on the understanding that it is a public institution with a social function subject to permissible regulation, it immediately went on the offensive intent on

protecting its assumed privacy and thwarting any effort to open its conduct to reasonable scrutiny. It dubiously asserted that the Registrar's decision to appoint an inspector in terms of section 44(4)(a) of the MSA constituted administrative action, demanded written reasons, alleged unreasonableness and unfairness, and threatened interdictory and review action. A scheme so opposed to regulatory scrutiny and transparency cannot be said to be committed to either a productive open relationship with the regulator or compliance with the regulatory requirements applicable to protected funds.

86. The Scheme's confrontational stance admittedly diminished while the section 44(4)(a) inspection was in progress. There was a genuine difference of opinion in correspondence between the Scheme and the Registrar about whether the inspector had a duty to afford the Scheme an opportunity to make representations on the contents of any inspection report prior to it being finalised and before any decision was taken to act on its content. It is not necessary to pronounce decisively on the relevant issues now. Suffice it to say that it is debatable whether a right to make representations must be afforded before completion of an inspection report. It is however definitely a requirement of procedural fairness that any action materially and adversely affecting the rights or legitimate expectations of a scheme requires it to be given a reasonable opportunity to make representations before action is taken.

87. In its notice of appeal in terms of section 49(1) of the MSA, the Scheme's first ground of appeal was that the Registrar had acted unfairly in that the Scheme was not given any notice of the nature and purpose of the directives issued on 15 June 2012, was not afforded any opportunity to make representations prior to the decision to issue the directives and was not provided with a clear statement of the proposed directives before they were made. The criticism appears to me, *prima facie* at least, to be well-

founded. Before a regulator can issue directives with such extreme and far-reaching consequences, it should hear the Scheme's viewpoint. In fairness to the Registrar though, the subject matter of the most significant directives had been fully canvassed in correspondence over the preceding two years and the different perspectives were known to both parties. Nonetheless, the Registrar's conduct was perhaps precipitate and heavy-handed. As with his incorrect assertion that he was entitled to levy a penalty of more than R1 million in terms of section 66(3) of the MSA, his conduct is open to the criticism of being over-zealous intervention, harmful to the possibility of a meaningful and constructive regulatory engagement.

88. Be that as it may, the taint of procedural fairness does not present a complete answer to the allegation that the Scheme was obstructive, nor is it by any means of itself defeating or dispositive of the Registrar's assertion that his legitimate concerns are such that curatorship has now become desirable.

89. While the section 44(4)(a) inspection was in progress a dispute arose in relation to the right of the inspector to gather evidence in the form affidavits, which has led the Registrar to accuse the Scheme of hindering the inspection by refusing to allow the Scheme's actuary and other witnesses to complete affidavits. Section 4(1)(a) of the Inspection of Financial Institutions Act[22] provides for an inspector to take evidence by administering an oath or by otherwise examining any person. Obtaining evidence by way of sworn affidavit, according to the Registrar, is one of the other ways in which an inspector may examine a person. The Scheme did not agree. In its view: a witness either testifies under oath or affirmation or not, and the Act does not provide for evidence to be taken by affidavit. I disagree. Taking evidence by the administering of an oath would include requiring a person to attest to evidence by affidavit. While

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[22] Act 80 of 1998

the record shows that the Scheme's attorneys might have had legitimate concerns about the content of proposed affidavits and that it may be debatable whether the refusal amounted to wilful hindrance of an inspector in the exercise of his powers, the stance taken by the Scheme undeniably contributed to the Registrar's perception that the Scheme was intent on deploying legalistic strategies to avoid co-operating in the inspection.

90. On balance, viewed across the entire period of the regulatory interaction, I am persuaded that the Scheme was unwilling to acquiesce properly to regulatory intervention and scrutiny, and instead resorted to posturing, with the result firstly of frustrating the investigation and later of delaying it. Such alone might justify the appointment of a curator in certain circumstances. But there is no need to make such a finding in this instance. The Registrar does not rest his case exclusively on the Scheme's obstreperous attitude. He views it rather as a significant, contributing factor, bolstering the allegation that good cause for the appointment exists, which is demonstrated more compellingly by the other irregularities and illegitimate conduct discussed below.

91. Before concluding in relation to this aspect of the case, I need to comment about the Registrar's standpoint regarding the notice of appeal filed in terms of section 49(1) of the MSA. As I have already pointed out, I hold the view that the Registrar would have done better to inform the Scheme that it had followed the wrong process. Not only did he not do that, doubtless preferring tactically to leave an element of surprise when bringing the curatorship application, he in addition professed that the Scheme's conduct in that respect was an attempt to frustrate his directives of 15 June 2012, and labelled such too as obstructive. In the replying affidavits, the Registrar's tone is dismissive of the right of the Scheme to seek redress against his directives. His mind-set is unfortunate. Although

he may be correct that the appeal provisions of the MSA are not applicable to the directives issued under the FIA, his letter of 15 June 2012 which included the directives gave no indication that they had been issued under that legislation. The Scheme's purported exercise of the right to appeal, was entirely legitimate, and could be construed favourably as a willingness to participate meaningfully in the statutory process. A fair, impartial and open-minded regulator would have immediately informed the Scheme that it had followed the wrong route and was required to bring a review. Instead the Registrar and Council remained silent for two months and then brought an *ex parte* application *in camera* for the appointment of a curator. While I accept the submission that an appeal under section 49 of the MSA, or a review in terms of Rule 53, would not legally preclude the bringing of a curatorship application, I reject the line of argument that in filing the appeal the Scheme was being obstructive. On the contrary, the manner in which the appeal was handled raises the spectre of an over-zealous, heavy-handed regulator who, perhaps at the end of his tether, had lost a measure of objectivity.

The alleged disregard of the legislation and the Rules of the Scheme

92. The Registrar has pointed to various transgressions on the part of the board of trustees and its chairperson as demonstrating a flagrant disregard of the provisions of the regulatory legislation and the Rules of the Scheme, which, he maintains, disclose a lack of fidelity to the law and principles of good governance, such as to disqualify them from their positions as trustees of a scheme vested with responsibility for billions of rand of public protected funds. He did not persist in argument with each transgression alleged in the papers but has concentrated rather on those he considered most serious and illustrative of the alleged lack of fidelity and non-appreciation of fiduciary responsibility.

93. During the course of his inspection, Mahlangu established that Mabeta, the chairperson of the board of trustees, contrary to rule 18.1.1 of the Rules of the Scheme, was not a member of the Scheme at the time he was first elected to the board in June 2008. Rule 18.1.1 provides for the election of board members by the members of the Scheme at the AGM, from amongst the members. Prior to Mabeta becoming a member of the Scheme he would have had no interest in the affairs of the Scheme and no right to serve on the board. In the answering affidavit, the Scheme admitted that Mabeta was not a member of the Scheme in June 2008 but became one only in November 2008. It maintained however that in terms of the Rules prior to November 2011 it was permissible for a non-member to become a trustee as an employer representative. However, notably, it failed to name the employer Mabeta supposedly represented. Mabeta did not file a substantive affidavit, but only a confirmatory affidavit including an averment that he confirmed the contents of Barnard's affidavit insofar as it referred to him. He too failed to shed light on the issue by naming the employer he represented.

94. In the replying affidavit the Registrar referred to the Mahlangu report in which it is recorded that Mabeta informed the inspectors that he was not a member of the Scheme when he was appointed as a trustee and was not nominated as an employer representative. In the supplementary opposing duplicating affidavit, Barnard (strangely not Mabeta) averred that Mabeta denied having advised Mahlangu that he was nominated as an employer representative. He annexed an extract of a minute of the AGM held on 18 July 2008 which he maintained clearly identified Mabeta as an employer representative. The relevant minute merely shows that Mabeta received 1001 votes as an "employer nominated representative". The extract does not state which employer nominated him and thus begs the essential question. One ordinarily would have expected Mabeta to deal directly with

this controversial issue in an affidavit. Instead he again merely confirmed generally the contents of Barnard's affidavit as it referred to him.

95. The Registrar's submissions regarding this issue are predictable. Barnard who only became a member of the Scheme in June 2012 had no personal or direct knowledge of the issue and his evidence in relation to it should be ignored as inadmissible hearsay. Mabeta's confirmatory affidavit is inconsequential and of no weight when he should and easily could have given evidence on the issue himself. Critically, the identity of the alleged employer is not mentioned in any affidavit and no substantiating documentation is annexed. Notwithstanding the averments in the replying affidavit and Mahlangu's report, the trustees failed to identify the employer in the supplementary opposing duplicating affidavit and counsel was unable to obtain a clear instruction in that regard during argument in court. As a consequence, the Scheme's denials regarding the election of Mabeta as a trustee are untenable and un-creditworthy to the extent that the averment of the Registrar on this factual issue must be preferred.[23] The minute stating that he received 1001 votes as an employer representative begs the question whether he had the required eligibility; which could have been answered easily by Mabeta himself or the employer he represented.

96. It follows that on the probabilities the Rules were indeed disregarded, and that a person not eligible for election to the board of trustees, or to be chairperson of it, served for a period illegally, until his re-election in 2011. In consequence the legality of some decisions of the board may be open to challenge. And, equally troubling, if the trustees were in truth unable to confirm Mabeta's eligibility to serve on the board during 2008-2011, they did not divulge that to the court during these proceedings and are either complicit in a cover up, or were negligent in the fulfillment of their fiduciary duties. The manner in which this issue has been dealt with on the papers

[23] *Plascon-Evans Paints Ltd v Van Riebeeck Paints (Pty) Ltd* 1984 (3) SA 623 (A) 634

not only reflects poorly on the propriety of Mabeta, but casts doubt upon the fidelity of the other trustees to the law, the Rules and the requirements of good governance. Counsel has further urged me to draw the inference that Mabeta was sourced as a trustee by an outside interested entity intent upon having its man on the board to serve its interests rather than those of the members. Given recent events, which I will examine more fully presently, the suspicion is understandable, but it is neither possible nor necessary to reach that conclusion on the evidence.

97. The Registrar disapproved also of a decision of the board to appoint Mabeta as chief executive officer ("CEO") of the Scheme. It is undisputed that the board of trustees appointed Mabeta to act as the CEO of the Scheme for the period September 2011 to February 2012 for a monthly salary of R99 290. The Registrar's first objection to the appointment is that the role of chairperson and CEO are incompatible from a governance perspective. He felt besides that the appointment led to Mabeta receiving excessive remuneration in an average amount of R150 000 per month during this period, which included his salary as CEO, a retainer fee for serving as a trustee and chairperson and an hourly fee for attending trustees' meetings. A charge of excessive trustee remuneration has been made in respect of all the trustees and in view of that I will deal with the issue separately later, after considering the rectitude of Mabeta's appointment as CEO.

98. It is industry practice for the principal officer of a medical scheme to be its chief executive officer. Section 29(1) of the MSA provides that the Registrar shall not register a medical scheme, and no medical scheme shall carry on any business unless its rules provide for certain matters, including the appointment of a principal officer by the board of trustees who is a fit and proper person to hold such office. The board is obliged to

give notice to the Registrar of the appointment.[24] And various persons (employers and officials of the administrator of a medical scheme) and brokers are disqualified from serving as a principal officer.[25] Rule 18.8.4 of the Rules of the Scheme goes further than the MSA by providing that the principal officer is disqualified from serving as a trustee. The Registrar has submitted that the MSA and the Rules of the Scheme do not countenance a CEO. Neither the MSA nor the Rules make specific or express provision for a CEO in addition to the principal officer.

99. Mahlangu reported that he was unable to ascertain whether Mabeta had fulfilled any meaningful role as CEO in addition to the tasks he performed as chairperson of the board. He thus intimated that the salary payment made to Mabeta was wasteful expenditure incurred for an improper purpose. The Registrar was moreover of the view that the appointment led to a conflict of interest since Mabeta had been party to the decision to appoint himself as the CEO.

100. Barnard, who was not a trustee at the time the decision to appoint Mabeta as CEO, averred in the answering affidavit that the appointment was justified because it was necessitated by the rigours of administering the scheme, and despite the generous salary, was only for three days a week. The appointment was made after taking legal advice and was communicated to the Registrar, who in effect declined to pronounce on the legality and advisability of the appointment, which was presented to him as a *fait accompli*. The Scheme sought to rely on Rule 21.2 which in its current formulation provides that the principal officer is *an* executive officer of the Scheme, as opposed to *the* executive officer, as appeared in an earlier formulation. The Scheme's attitude was that the principal officer was therefore but one executive of the Scheme among others, and it was

[24] Section 57(4)(a) of the MSA
[25] Section 57(7) of the MSA

within in its rights to appoint a chief executive despite the prescriptions in the Rules in relation to the principal officer.

101. The answering affidavit is conspicuously lacking in any detail about the additional functions performed by Mabeta and makes no effort to address the Registrar's concern about desirable governance practices and the avoidance of a conflict of interest.

102. I agree with the Registrar that it is undesirable from the perspective of good governance for a chairperson of the board to act as the CEO of a scheme. Most of all, I agree that the intention of the Rules and the Act, read together and purposively, is that the principal officer will serve as the CEO of the Scheme. The adjectives "principal" and "chief" are synonymous and transposable. For good governance reasons, the Rules expressly prohibit the appointment of a trustee as the principal officer. The board knew that, as is evident from the fact that when another trustee, Mr. Stuart, acted as the principal officer he resigned as a trustee. The Rules do not explicitly provide for the appointment of a CEO and such a rule should not be implied in the Rules, because it would offend against the underlying rationale that the checks and balances in good corporate governance require a clear separation of powers between the board and the chief executive of the Scheme. Where there is no express provision in the rules of an institution, a court should be very slow to infer the existence of such a power by implication especially when the general scheme of the legislation, the rules and prevailing industry practice point to an intention that the principal officer of a medical scheme should be the sole chief executive officer.

103. The appointment of Mabeta as CEO was accordingly *ultra vires* the Rules and null and void.[26] I might add that the appointment offended Principles

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[26] *Grundling v Beyers* 1967 (2) SA 131 (W) at 139

2.16 and 2.17 of *King III Report on Governance for South Africa – 2009*, which recommend that a CEO should not also fulfill the role of chairperson of the board. Good governance expects the board to define its own levels of authority, reserving powers to itself and delegating to management, and recognises that because of the strategic and operational role of the CEO, and the need to prevent too much power vesting in one person, the appointment of the CEO as a rule should be separate from that of chairperson of the board.

104. The appointment being *ultra vires* the Rules, the expenditure on Mabeta's salary was in all probability wasteful and unlawful and the Registrar within his powers to direct its recovery. Illegal and wasteful payments can never be in the interest of the beneficiaries of the Scheme. The trustees' conduct in continuing to defend their decision, despite the compelling criticism of it, further demonstrates a lack of fidelity to the rules and incapacity in fiduciary responsibility.

105. There is a dispute of fact about whether Mabeta recused himself from the meeting appointing him as CEO. I see no necessity to resolve it; the appointment was improper and that casts doubt enough.

106. I turn now to the question of trustee remuneration. The directives issued by the Registrar on 15 June 2012 instruct the Scheme to recover the amounts paid to the trustees as "retainer fees" from 2008 to date. In the founding affidavit the Registrar challenged the trustees' entitlement to a retainer fee as such, but also contended that the payments to trustees were excessive. The chairperson of the board, as mentioned, was also censured for receiving excessive remuneration as the CEO. The Registrar has directed that these amounts be recovered too.

107. The Registrar deems the payment of a retainer fee to be contrary to the common law regulating the remuneration of trustees. At common law a trustee is entitled to be indemnified out of the trust property for expenses properly incurred in the course of administration and to remuneration for services as provided for in the trust instrument, or if no such provision is made, to a reasonable remuneration.[27] Remuneration is the *quid pro quo* for services rendered.

108. The Rules of the Scheme do not specifically determine the remuneration payable to trustees. Rule 19.18 obliges the board to disclose annually in writing to the Registrar any payment or consideration made to members of the board. Rule 2.20 grants the board the power to do anything which it deems necessary or expedient to perform its functions in accordance with the provisions of the Act and the Rules, and Rule 20.3 empowers it to appoint committees of the board as it may deem appropriate. The retainer fee and other fees payable to trustees are provided for in yearly remuneration "manuals" approved by the board's remuneration committee and the board.

109. The remuneration manual of 2012 discloses that the trustees received monthly retainers as follows: Chairperson R42 130; Vice Chairperson R25 520; Member of the Executive Committee R17 060; and other trustees R11 500. In addition trustees receive R4000 per meeting attended (the Chairperson receives R5000). The manual also provides for payment of R1500 per hour for specific tasks performed outside the normal duties of a trustee. Clause 1.7 of the manual defines the purpose of the retainer fee as being "intended to cover trustees for the personal, fiduciary and reputational risk undertaken for being a trustee, and also reasonable work outside of meetings required in order to fulfil the mandate of the position held". Clause 1.8 provides that the retainer will also cover

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[27] Cameron: *Honore's South African Law of Trusts* (5th Ed) at 345

time spent by the trustees on meetings with the Scheme's service providers and suppliers.

110. The Registrar's complaint that the payment of a retainer in the trust context is inappropriate is in my judgment somewhat pedantic and unconvincing. As he sees it, payment for reputational risk is not part of reasonable remuneration because no work is undertaken in return. While I accept that the use of the term "retainer" in the manuals is unusual and perhaps a case of inexact usage, I do not regard the payments to be improper. It is indeed uncommon when referring to remuneration payable to a trustee to talk of a retainer fee. Such is used typically to refer to an amount payable to a professional to hold services available for the preferred client paying it, without a *quid pro quo* beyond that. Even so, I accept the Scheme's submission that it is not irregular to pay trustees a "trustee fee" in addition to remuneration for board attendance and specific contractual tasks outside the scope of a trustee's duty. Principle 2.25 (153) of *King III Report on Governance for South Africa - 2009* lays down the applicable guideline as follows:

> "Non-executive director fees, including committee fees, should recognize the responsibilities borne by directors throughout the year and not only during meetings. Fees should comprise a base fee which may vary according factors including the level of expertise of each director as well as attendance fee per meeting."

111. The Registrar's objection to the payment of a retainer fee is thus tenuous. The retainer fee was manifestly intended to be the base fee acknowledging the responsibilities borne by the trustees during the year and is an acceptable form of remuneration, provided it is disclosed, as it in fact was in this case.

112. The charge that the trustee remuneration is excessive, beyond the bounds of reasonableness is, of course, a separate matter. The Mahlangu Report revealed that the trustees were paid handsomely. Mabeta at one stage earned more than R150 000 per month, while average trustee remuneration was about R280 000 per year, which seems generous for a non-executive fiduciary position. However, I agree with counsel for the Scheme that the Registrar has failed to make out any case demonstrating that the trustees have been remunerated beyond the acceptable norm. He has furnished no evidence against which the amounts paid to the trustees can be benchmarked. It is for that reason not possible to decide on the papers that the board breached its duty to pay remuneration which is reasonable.

113. The Scheme in the answering affidavit made the general submission that the concerns raised regarding the governance failures, in light of the financial soundness of the Scheme, were immaterial and in any event subject to appeal. I have stated my views concerning the appeal. For present purposes the enquiry is limited to the materiality of any proven irregularities and whether the Registrar's concerns disclose good cause for the appointment of a curator. Even though the Scheme is financially sound that alone will not avert the appointment of a curator where in the governance of the Scheme there has been non-observance of the principle of utmost good faith, improper conflicts of interest and a concomitant subordination of the interests of the beneficiaries to those of outside persons, in particular service providers.

114. The Scheme's further submission that since the governance concerns were in existence for a few years the Registrar could not have considered them material is equally unpersuasive. When the Registrar encountered resistance to his directive aimed at undoing the harmful consequences of the illegal payment of R28 million in research fees, his persistent attempts

to conduct an inspection were impeded mostly by reason of the Scheme's conduct. He acted promptly upon completion of the Mahlangu inspection in August 2012. Most important of all, his view that an illegal payment of R28 million to a service provider, an election of an ineligible person as a trustee and the inappropriate appointment of that person as the CEO are material irregularities, is in fact right. Whether they, together with the Scheme's reluctance to submit to an inspection, are of an order as to make the appointment of a curator desirable may have been debatable at the time the rule *nisi* was granted *ex parte*. The Scheme might have prevailed at that stage with an argument that the Registrar ought to have resorted to less drastic remedies such as the removal of the trustees in terms of section 46 of the MSA, or an application in terms of section 6 of the FIA for an order compelling the Scheme to comply with his directives. That line of argument falls to be assessed now in the light of the information uncovered by the provisional curator on the subject of the Scheme's relationship with Sapling.

The Sapling contract and the election of the Sapling trustees

115. The conduct of Sapling aimed at securing its contractual interests has added another dimension to the dispute. The Scheme has argued that the Registrar has raised the Sapling relationship only because he realised that the relief sought was unlikely to be granted on the basis of the allegations contained in the founding affidavit. By introducing the supplementary allegations, it was submitted, he sought to rely on a completely different ground based on new matter not incorporated in the founding affidavit and never raised previously.

116. As I understand the situation, the Registrar does not abandon his position in relation to any directive issued on 15 June 2012, even though he has not persisted in argument with all of them. He merely believes that the

irregularities in relation to the research fees, the improper election of Mabeta to the board in 2008, his appointment as CEO, and the concern about excessive remuneration, together with the uncooperative approach taken by the Scheme to regulatory intervention, provide sufficient good cause for the appointment of a curator. And, if there remained any reservations about whether these cumulatively furnished sufficient good cause for the appointment of a curator, they have been obviated, in his opinion, by the alleged irregularities in relation to the election of the board of trustees on 28 June 2012 and the propriety of the relationship with Sapling. As said before, the application must at this stage be determined on the evidence currently available and with consideration being given to any feasible, alternative remedies.

117. The issue regarding the Sapling contract originally was linked to the illegal payment of research fees to brokers. In its letter of 22 December 2010, which was concerned principally with the illegal payment of research fees, the Council stated:

> "Given the fact that payments for these research fees were facilitated by Medshield Distribution Services and that the Scheme is contemplating acquiring the business of Medshield Distribution Services, this process must be undertaken in order to terminate the relationship with Medshield Distribution Services after objectively establishing the best route to follow in this regard."

118. In its letter of reply, dated 14 January 2011, the Scheme informed the Registrar that it was in the process of conducting the necessary investigation to inform its decision to acquire the business of MDS and would keep the Registrar up to date of its progress. The Scheme had told the Registrar in previous correspondence that it intended to acquire the business of MDS so that the distribution services supplied by MDS would in future be rendered by the Scheme. The Registrar felt the Scheme's response in its letter of 14 January 2011 was inadequate and he said as

much in a letter to the Scheme dated 21 January 2011. To this the Scheme replied:

> "In the meantime, the Scheme will not proceed with the acquisition process as your office is clearly not satisfied with the adequacy of what the Scheme is doing in that regard and it is not the intention of the Scheme to have endless correspondence with your office on this issue. If your office is not satisfied with what the Scheme is doing it is incumbent upon your office to specify as to in what respects it is not satisfied rather than to simply state that the response "is again inadequate"."

119. As discussed earlier, during the Mahlangu inspection, in his letter of 17 January 2012, the attorney for the Scheme informed the Registrar that there was no directive that precluded the Scheme from continuing with the MDS contract, but that in any event the MDS contract had been terminated and a new contract to perform the services had been concluded with Sapling. The Sapling contract is a detailed document of more than forty pages. It provides that the contract will endure for a period of three years, expiring on 31 December 2014. The prospective income deriving from it for the benefit of Sapling has been put at R44 million per annum. Its value for the aggregate contract period is thus about R135 million. The contract requires Sapling to provide the Scheme with products (defined to mean office facilities, premises, environment and software) and services as set out in the specifications. These specifications do not form part of the record. Absent the specifications, it is not possible to assess accurately the correctness of Mahlangu's finding that the contract resulted in a duplication of services. His criticisms are nevertheless still deserving of some consideration.

120. Mahlangu disapproved of the MDS contracts on various grounds. The inspection report seeks to justify the finding that the MDS contract involved a significant duplication of services, and the consequential claim

that the payments in terms of the contract were wasteful and irregular, by setting out in tabular form an analysis of and commentary on the various services, comparing them to those offered by other providers.[28] The table reflects that there was a suspected duplication of the services performed by Medshield Brokers (Pty) Ltd and those to be rendered by MDS, and that certain services listed in the MDS contract would ordinarily be fulfilled by brokers, the administrator or the Scheme. Mahlangu also claimed that excessive payments had been paid to MDS and that there was no proper procurement process followed in the appointment of MDS and later in the substitution of Sapling for MDS. Moreover, the report notes that there are a number of interlocking directorships on the boards of MDS, Medshield Brokers (Pty) Ltd and Sapling. These findings, no doubt, inspired the Registrar to issue his directive on 15 June 2012 directing the Scheme to terminate the contractual relationship with Sapling, which contract replaced the previous contract with MDS. He questions whether the Scheme is getting value for its money and is acting in the best interest of the beneficiaries. He fears that the funds of the Scheme are being used for the improper advantage of Sapling and its shareholders to the prejudice of the Scheme beneficiaries.

121. The Scheme denied that the agreement entailed a duplication of services and averred (incorrectly) that Mahlangu had not stated the grounds on which reliance is placed for his conclusion. It put up some defence of the contract, explained the process involved and the discussions at board level before the contract was concluded, and cautioned against terminating the contract on grounds that the disruption caused would do damage to the Scheme. It justified the value of the contract as being the provision of a support structure to brokers, claiming that "Sapling consolidates the relationship between the scheme, the brokers, the corporate and individual members". Still, the Scheme's answer, beyond

[28] Paragraph 3 at page 142 of the Mahlangu Report.

referring to the supply of information software and hardware with concomitant training and support, is vague about the nature, purpose and extent of the services rendered by MDS and does not distinguish them from those furnished by the Scheme itself and other service providers. In other words, the Scheme fails adequately to address the essential criticism that the contract amounts to a duplication of services because they are already rendered by others or can be provided more cost effectively. Be that as it may, it is not necessary to determine whether there was in fact a duplication of services. It is sufficient to understand that Mahlangu's finding prompted the Registrar to issue the directive. What followed that event is of greater importance for present purposes.

122. The Scheme did not abide the Registrar's directive of 15 June 2012 to terminate the Sapling contract. As the provisional curator explained in his report, less than two weeks later on 28 June 2012, five trustees were elected to the board by four persons holding a large number of proxies who were associated in one way or another with Sapling. It is common cause that Mr. J le Roux, the CEO of Sapling, who was previously the CEO of MDS, played an active role in the election of the Sapling trustees.

123. In the six months prior to the issue of the directive on 15 June 2012 Sapling earned R22 million from the contract and was set to earn approximately R110 million more over the life of the contract. One might have expected Sapling to protect its interest by attempting negotiations with all interested parties or to have come to court to defend the merit of the contract and the value of the services. Instead it remained silent and opted to gain greater influence on the board of trustees by having persons seemingly associated with it elected to the board and by participating indirectly in the opposition to the present application by indemnifying the trustees against legal costs.

124. In the earlier analysis of the events of the AGM of 28 June 2012, I accepted that the intention of the Rules is for the proxy form sent to members to be sent with all other relevant documentation in order to ensure that before granting a proxy the member is fully acquainted with the affairs and governance of the Scheme. The provisional curator is convinced that this probably did not happen, as many of the proxies were signed before the AGM documentation was distributed to members and some were not in the proper form. Other facts point to the probability of irregularities in relation to the receipt of nominations and proxy forms.

125. Of the thirty eight members who attended the AGM, ten were the current trustees, including the five Sapling trustees elected by the four persons associated with Sapling using possibly irregular proxies to vote in favour of them *en masse*. Le Roux, the CEO of Sapling, who was in possession of a large number of proxies himself, seems to have procured proxies and acted to ensure that the Sapling trustees were elected. The belief of the provisional curator and the Registrar is that Sapling in doing this was manifestly attempting to protect its own interests arising from the distribution services contract; which is borne out by the unusual fact that the Sapling trustees had joined the Scheme as members shortly before the AGM with most of them transferring without their dependants from schemes of which they had been members for years.

126. The fact of collusion, ironically, is confirmed by the untenable and un-creditworthy explanation offered by Barnard for his taking the unusual step of joining the Scheme. In paragraph 30.2 of the supplementary opposing duplicating affidavit in response to the allegation of orchestration, Barnard states:

> "I, for example, was made aware of the election by certain of my friends. I was interested to take part in the election as I considered that my legal experience and management skills should be of benefit to the scheme and its members."

He denied knowing of either Sapling or Le Roux prior to his election. He neglected though to identify the friends who had encouraged him to join the Scheme and stand for election. I agree with counsel for the Registrar that it is improbable, even fanciful, that a person who had no prior relationship with the Scheme would make himself available simply because his skills and experience "would be of benefit to the scheme and its members", and that such a motive propelled him (as well as the other Sapling trustees) to cancel his existing membership of a scheme (of which membership by his wife and children was too advantageous to terminate) and to make himself available to nobly serve the Scheme. And that, thereafter, by pure coincidence, four Sapling employees secured large numbers of proxies which they used to elect him, despite the fact that none of his electors knew or had any association with him. Counsel's labelling of that proposition by Barnard as fanciful may be an understatement, being made under oath, as it was, by an attorney and an officer of this court.

127. The Scheme, arguing that the Sapling trustees as members of the Scheme were all eligible for election, contended that there was nothing illegal in the concerted take-over of the board. It has offered various explanations and justifications for the alleged irregularities relating to the proxies; for instance, pointing out that it was mentioned in the notice convening the AGM that the financial information was available to members on the website. Proxy forms, it claims, were also dispatched to outlying areas prior to sending out the AGM packs. Rule 27.2 and Rule 26.1.2 however require something different - the proxies must be accompanied by the relevant AGM information packs.

128. Be that as it may, the Scheme (or at least Barnard, the deponent to the affidavit, himself one of the Sapling trustees) would appear not to

appreciate that the orchestration of the election in the manner it occurred generated a conflict of interest which the trustees were duty bound to avoid. In light of the history, the apprehension now is that the board will not ensure that the interests of the beneficiaries are adequately protected under the Sapling contract. The orchestration of the result of the election was in all likelihood aimed at advancing the interests of Sapling, which may be, or yet prove to be, inimical to those of the beneficiaries.

129. The Registrar's anxiety that Sapling has acquired indirect control of the board of trustees by means of an orchestrated and possibly irregular election for the purpose of protecting its interests under a contract regarded as suspect is therefore well founded. In as much as there may be disputes of fact regarding the regularity of the election and the authenticity of the proxy forms, I reiterate the remarks of Wallis JA in *Dynamic Health*[29] that when dealing with the investment of the funds of the public, where considerable hardship will be suffered by ordinary people if things go wrong, the Registrar cannot be expected to resolve factual disputes by litigation before obtaining an order appointing a curator. The result of the board election is undisputed, as is the fact that the Sapling trustees were elected by Sapling employees holding proxies from members obtained in an unconventional manner. The concerns of the provisional curator and the Registrar that the election may have been irregular and manipulated for the benefit of a service provider, albeit perhaps not conclusively established, are nonetheless legitimate.

130. The fact that Sapling is funding the trustees' opposition to the application strengthens the Registrar's trepidation that the board is beholden to Sapling. In addition to the reasons he gave for the trustees accepting the funding, Barnard justified the stance of the trustees on the basis that Sapling in any event had *locus standi* to oppose the application by virtue

[29] Note 4 *supra* at para 6

of its interest in the ongoing contract to provide distribution services. That may indeed be so, but the fact remains that Sapling did not seek to intervene in its own name to seek relief related to the performance of the Scheme's contractual obligations. It opted rather to oppose the appointment of a curator by indemnifying the trustees. Whatever the funding difficulty the trustees might have faced, the indemnity inexorably gives rise to the possibility of a future conflict of interest, which the trustees have not taken reasonable steps to avoid, as they are legally required to do in terms of section 57(6) of the MSA. The Registrar has directed the Scheme to terminate the contract because it advantages Sapling to the prejudice of members. The trustees' ability to respond objectively to that directive is now unpromising. The indemnity compromises the trustees' ability to assess the ongoing implementation of the Sapling contract impartially. Sight cannot be lost of the fact that five of the trustees owe their election to Sapling and the entire board has chosen to go along with the indemnity. That alone gives rise to a reasonable apprehension that the board of trustees, as presently constituted, is not in a position to assess and administer the Sapling contract in a detached and unbiased fashion.

Conclusion

131. The entire board therefore has compromised its ability to fairly assess the value of the Sapling contract and its benefit for members. The lack of fidelity to the rules and non-observance of the principles of fiduciary governance by the non-Sapling trustees, who were re-elected in June 2012, does little to inspire confidence that they would act appropriately were only the five Sapling trustees to be removed. All the trustees are conflicted, meaning inescapably that good cause exists for the appointment of a curator. The Scheme will otherwise be without an effective means of governance. A curator offers the only solution to the

impasse and will be best placed to resolve the possible conflict of interest arising under the Sapling contract and to put the Scheme's relationship with its service providers on a proper footing. He then can arrange for another election of the board of trustees to be conducted under the supervision of an independent person. I am accordingly persuaded that it is necessary and desirable for the curator to be finally appointed to sort out the unresolved regulatory concerns.

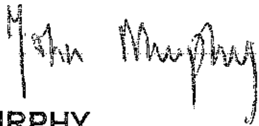
132. In the result, good cause exists for the appointment of a curator and I am satisfied that it is desirable to confirm the rule *nisi* and make the appointment. The Scheme has objected to the provisional curator's supposed lack of relevant experience in the field of medical schemes and would prefer someone of its own choosing. Mr. Langa is an experienced attorney and reputable officer of the court. His report demonstrates that he is a person of ability, competence, insight and sound judgment. I accept that he is a fit and proper person and see no reason why he should not be appointed as a curator.

133. There is no reason why costs should not follow the result. The costs shall be paid by the intervening parties jointly and severally, the one paying the others to be absolved. The Registrar seeks a punitive order as a mark of the court's disdain for the obstructive conduct of the trustees of the Scheme and the orchestrated attempt by Sapling, in which the trustees colluded, to gain influence over the board. I agree that such an order is warranted. The complexity of the matter justifies the employment of two counsel.

134. No other submissions were made by the Scheme regarding the scope and ambit of the order sought in the notice of motion. In the result, the following orders are made:

a) The rule nisi issued on 2 October 2012 by this court is confirmed, and a final order is made in accordance with paragraph 8 of the notice of motion.

b) The intervening parties are ordered to pay the costs of the application jointly and severally, the one paying the others to be absolved, such costs to be on the scale as between attorney and client and to include the costs occasioned by the employment of two counsel.



JR MURPHY
JUDGE OF THE NORTH GAUTENG HIGH COURT

Date Heard:	15 & 16 November 2012
For the Applicant:	Adv M.C. Maritz SC
Instructed By:	Savage, Jooste & Adams Attorneys
For the Respondent:	Adv J.H. Dreyer SC
Instructed By:	Geyser Van Rooyen Attorneys