REPUBLIC OF SOUTH AFRICA

IN THE HIGH COURT OF SOUTH AFRICA

GAUTENG DIVISION, JOHANNESBURG

(1) REPORTABLE: No
(2) OF INTEREST TO OTHER JUDGES: No

5/6/2023
DATE

SIGNATURE

CASE NO: 2021/36175

In the matter between:

EDMUNDS, NEIL JOHN — First Applicant

SCHULTZ, FRANZ JOSEPH — Second Applicant

and

SUPREME MOULDINGS INVESTMENTS (PTY) LIMITED — First Respondent

SUPREME MOULDINGS (PTY) LIMITED — Second Respondent

Neutral citation: *Edmunds Neil John & Another v Supreme Mouldings Investments (Pty) Ltd & Another* (Case No: 36175/2021) [2023] ZAGPJHC 635 (05 June 2023)

JUDGMENT

This judgment is deemed to be handed down upon uploading by the Registrar to the electronic court file.

Gilbert AJ:

1. The applicants in this matter, as minority shareholders, seek in terms of section 163 of the Companies Act, 2008 that their minority shareholding in the first respondent be repurchased by the first respondent.

2. The applicants are minority shareholders holding some 10% of the shares in the first respondent. The first respondent in turn is the holding company of the second respondent. I shall refer to the first respondent as Investments and the second respondent as Supreme Mouldings.

3. Supreme Mouldings is the operational company which engages in the business of the manufacture and distribution of wooden and styrene frames, mouldings and accessories, being the nature of its business described in its annual financial statements. It conducts its manufacturing business primarily from a factory situated in East London with a warehouse, offices and showroom situated in Roodepoort.

4. The applicants were at various relevant times directors of one or other or both of Investments and Supreme Mouldings. The first applicant resigned his directorship in September 2020, having been the managing director of the group for some time. A reference letter written on behalf of Supreme Mouldings for the benefit of the first applicant when he exited the group in September 2020 describes the first applicant as having been in the employ of Supreme Mouldings for some 29 years, that he had started his

career at Supreme Mouldings as a sales representative and that he rose through the ranks to his position as the group managing director.

5. The group was effectively founded in the 1990s by Michael Formato. Unsurprisingly then, ultimately the majority of shares in Investments is held by Formato, either personally or through a family trust and so it can fairly be said that Formato controls Investments, and, through its shareholding in Supreme Mouldings, that company too.

6. It appears from the papers that as the first applicant made his way up the ranks, he obtained a small shareholding in Investments. It is that shareholding, as a small minority shareholder in Investments, that he relies upon for purposes of his *locus standi* in this application.

7. While the first applicant did also have a shareholding directly in Supreme Mouldings, he returned this shareholding and so by the time this application was launched he was no longer a shareholder in the operating company.

8. The position and history of the second applicant is not quite as detailed in the affidavits. Nonetheless it appears that the second applicant was until his exit the financial director of the group or one or other of the companies and that he too acquired a small shareholding in Investments. The second applicant's *locus standi* too in this matter is based upon his small shareholding in Investments.

9. Notably, neither of the applicants are shareholders in Supreme Mouldings nor are they directors of either of the companies. This limited their *locus standi* in these proceedings to that of a shareholder in Investments.

10. The applicants allege that Supreme Mouldings, as a related party to Investments[1] and at the instance of Formato, has conducted itself in such a manner that is oppressive or unfairly prejudicial to, or unfairly disregards their interests as minority shareholders in Investments. The applicants contend that the appropriate relief to bring an end to the matters complained of is that Investments effectively purchase their shareholding at fair market value, after taking into account various factors, and that to give effect thereto an independent appraiser be appointed to establish that fair market value.

11. For the applicants to succeed in their relief under section 163 of the Companies Act, they need to establish:

    11.1. the particular act or omission, or conduct of the business of the Investments, of which they complain has been committed by Supreme Mouldings;

    11.2. such act or omission or conduct of which they complain is unfairly prejudicial to them as shareholders of Investments, or unfairly disregards their interests as shareholders of Investments;

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[1] See para 10, 25.6, 44 and 49 of the founding affidavit.

11.3. the nature of the relief that they seek will bring an end to the matters complained of; and

11.4. it is just and equitable that such relief be granted.[2]

12. What is the oppressive or unfairly prejudicial conduct of Supreme Mouldings of which the applicants complain as minority shareholders in Investments?

13. During November 2018, Supreme Mouldings, through Formato, concluded a guarantee and security cession of loan accounts in favour of ABSA Bank for finance facilities advanced by the bank to two associate companies. These two associate companies, which are ultimately also controlled by Formato, were granted finance by the bank but subject to Supreme Mouldings furnishing a guarantee in the bank's favour pursuant to which Supreme Mouldings guaranteed payment of the indebtedness to the bank. Supreme Mouldings further ceded its claims on loan account against the associate companies to the bank as security.

14. It is common cause that the necessary requirements for Supreme Mouldings to enter into what effectively is financial assistance by it to the associate companies were not complied with. What this meant is that Supreme Mouldings has given financial assistance to the associate

[2] *Louw and Others v Nel* 2011 (2) SA 172 (SCA) at para 23, in relation to relief under section 252 of the previous Companies Act, 1973. This dictum was subsequently cited with approval and applied by the SCA in *Grancy Property Limited v Manala and Others* 2015 (3) SA 313 (SCA) at para 25 in relation to section 163 of the Companies Act, 2008, as the successor to section 252 of the previous Companies Act, 1973.

companies contrary to the provisions of section 45 of the Companies Act, particularly when it came to *inter alia* the passing of the necessary directors' and shareholder resolutions. Neither of the applicants participated in these transactions, particularly the first applicant who at the time remained the managing director[3] and, at the time, was a shareholder in Supreme Mouldings.

15. Formato, who it will be recalled ultimately controls the Group through his effective majority shareholding, explains himself *inter alia* on the basis that documents were prepared by the bank and given his controlling position, he was unaware that he was not entitled to sign the various documents and resolutions to give effect to the furnishing of the security cession and guarantee. Of course, this is not an adequate explanation for his failure and that of Supreme Mouldings to comply with the statutory requirements of the Companies Act when it came to such financial assistance, but these transgressions must be seen in the context of the applicants' case as framed in terms of section 163.

16. The applicants would only discover in March 2020 that such guarantee and security cession had been given. Their complaint and what gives rise to what they contend is conduct that is oppressive or unfairly prejudicial to, or unfairly disregards their interests as minority shareholders in Investments is described as follows in their founding affidavit:

[3] Although there is some dispute as to whether the first applicant remained a director, ultimately it is not relevant.

> *"The aforementioned unilateral actions [i.e. the conclusion of the guarantee and security cession] taken by Formato, as will be shown below, resulted in the oppressive and/or prejudicial conduct towards the minority shareholders in the Investments Company being a related person to the Moulding Company which ultimately culminated in a substantial diminution of the share value of such shares and for the sole benefit of the beneficiaries of the MAF Trust, being Formato …*
>
> *The substantial diminution in the value of the shares of Edmunds and Schultz [the applicants] in the Investments Company becomes clear when regard is had to the above actions by Formato on behalf of the Mouldings Company and the consequent impact thereof as is evident from the adjusted financial statements for the year-ended 30 June 2019 …".*[4]

17. It is not the fact itself of the irregular conclusion of the guarantee and security cession (i.e. the non-compliance with the various statutory requirements for *inter alia* financial assistance in terms of section 45) that constitutes the oppressive or unfairly prejudicial conduct of which the applicant complain but rather the prejudicial effect of those transactions on Supreme Mouldings, which in turn diminished the value of the applicants' minority shareholdings in Investments as the holding company of Supreme Mouldings. This is consistent with the legal position that it is the result of the conduct (whether in the form of an act or omission) that must be unfairly prejudicial and not the conduct itself.[5]

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[4] See paras 25.6 and 26 of the founding affidavit.

[5] *Count Gotthard SA Pilati v Witfontein Game Farm (Pty) Ltd and others* [2013] JOL 30003 (GNP), para 17.6. See also *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC), para 54 at 193:

18. The applicants' case is that the value of Supreme Mouldings was adversely affected by its concluding the guarantee and security cession in that Supreme Mouldings has a large exposure to the bank should the bank call upon the guarantee and in that the cession by Supreme Mouldings to the bank of Supreme Mouldings' claims on loan accounts against the associated companies resulted in a diminution in the assets of Supreme Mouldings. This, the applicants' case continues, in turn translates into a diminution in the value of Investments shareholding in Supreme Mouldings, which in turn resulted in a diminution in the value of their minority shareholding in the Investments company.

19. It is necessary to look at this impugned conduct more closely.

20. It is conduct that took place at the level of the operating company Supreme Mouldings in the group. Although Formato was the natural person directly responsible directly for the impugned conduct, he did so on behalf of Supreme Mouldings. It is common cause that Supreme Mouldings is a "related person" to Investments and therefore the impugned conduct as ascribed to it does constitute an act or omission that falls within the ambit of section 163(1) insofar as it constitutes the conduct of a person that is relevant for the operation of that section.

"The test focuses on the effect of the conduct complained of"; and *De Sousa and another v Technology Corporate Management (Pty) Ltd and Others* 2017 (5) SA 577 (GJ) para 601C: *"The effect of the challenged conduct is the real issue…".*

21. As the applicants were neither shareholders nor directors of Supreme Mouldings when this application was launched in 2021, it is understandable why they seek to establish *locus standi* through Investments as the holding company in which they are still shareholders. To bridge this gap between Supreme Mouldings where the impugned conduct took place in the form of the irregular conclusion of the guarantee and security cession and Investments in which they remain shareholders, the applicants seek to link the unfairly prejudicial effect of the impugned conduct to a diminution in value of the shareholding held by Investments in Supreme Mouldings and in turn, indirectly, to an indirect diminution in their shareholding in Investments.[6]

22. But does this attempt to bridge the gap suffice?

23. The respondents argue that the prejudicial effect that the applicants complain of is "*theoretical*" in that it has not arisen, and may never arise, and that kind of conduct is insufficient to found relief under section 163. The argument is that it is only if the bank calls up the guarantee and/or seeks to realise the security in the form of the ceded debts that there will be an actual diminution in the value of Supreme Holdings and a potential knock-on diminution in the value of Investments and further in the applicants' minority shareholding in Investments. This is because the

[6] As held in *De Sousa* above para 43 : "*Conduct which adversely affects or is detrimental to the financial interests of a member is justiciable under [section 252 of the previous Companies Act, 1973]. Thus relief may be claimed where it can be shown that the value of a member's shareholding in a company has been seriously diminished or jeopardized by reason of unfair, unjust or inequitable conduct on the part of those who have control of the company*".

obligations under the guarantee are contingent, and therefore do not feature in the balance sheet in the annual financial statements, although disclosed therein by way of notes. Neither does the balance sheet in the annual financial statements reflect that the debts ceded as security are no longer assets of Supreme Mouldings, because until the bank seeks to realise that security by acting upon that cession, the debts remain assets of Supreme Mouldings.

24. In my view, there is merit in this argument. At first glance, Supreme Mouldings would appear to have been in a better position if it did not undertake a contingent guarantee obligation towards the bank in respect of the indebtedness of the associated companies that may change into an actual liability and if it had not given a security cession of certain of its claims. But this does not translate into a diminution in value as contended for by the applicants, when a wider commercial perspective is taken of the matter. I say so for the following reasons.

25. Formato for the respondents in his answering affidavit describes the commercial relationship between Supreme Mouldings and these associated companies. These associated companies each own a property, i.e. they are property-owning companies.[7] The one associate company owns the East London factory, which is leased by Supreme. The second associate company owns the Johannesburg property, which Supreme Mouldings leases as its offices, factory and showroom. Formato

[7] Although one of these entities is a close corporation, for ease of reference, I shall continue to refer to them as associate companies.

describes in his answering affidavit that these companies give favourable rental rates to Supreme Mouldings, attaching evidence of comparative rentals.

26. Formato also describes in his answering affidavit that these associate companies as lessors afforded substantial rebates to Supreme Mouldings in rentals during the Covid-19 pandemic.

27. Formato describes in his answering affidavit that the financing facilities made available by the bank to the associate companies was also used for the benefit of Supreme Mouldings, i.e. that it was not a matter of Supreme Mouldings putting up security for financing facilities in respect of which it received no benefit. Formato describes how some R10 million was made available by the associate companies through financing facilities to Supreme Mouldings during the height of the Covid-19 pandemic, providing cashflow to Supreme Mouldings to see it through the pandemic.

28. The applicants in their replying affidavit did not seriously challenge the factual veracity of these averments but rather contend that they are irrelevant. The relevance of these averments is that it demonstrates that whatever the irregularities may have been in Supreme Mouldings giving financial assistance that enabled these facilities to be put in place, if regard is had to the larger picture Supreme Mouldings benefited from those financial facilities.

29. Can it the be said that the applicants have demonstrated that the irregular transactions did ultimately result in a diminution in the value of their

shareholdings in Investments as the holding company? When regard is had to the bank now some five years not having called upon the guarantee and security cession, and so there does not appear to have been any discernible prejudicial effect of those transactions on the value of Supreme Mouldings, and in turn on the value of Investments and the minorities' shareholding, together with the upside of the benefits that Supreme Mouldings derived from these facilities, the irregular transactions do not have the effect that the applicants seek to ascribe to that conduct for purposes of founding their relief.

30. Notably, the applicants' complaint is not that Formato's unilateral conclusion of irregular transactions resulted in an irretractable breakdown of a relationship of trust between the applicants, on the one hand, and Formato, on the other hand and that this constitutes a basis for Investments being compelled to repurchase their minority shareholding. While it may be that the first applicant exited Supreme Mouldings in September 2020 when Formato declined to put right the impugned conduct, and that this resulted in a breakdown of their relationship (and which appeared to have been on shaky ground for several years before then), this would not avail the applicants. Neither of the applicants contend that the companies were formed or conducted on an underlying basis that they had a legitimate expectation to participate in the management of the company, as would be the case in a domestic company or quasi-partnership.

31. This is understandable as neither of the respondents nor the Group as a whole can be construed as a domestic company or quasi-partnership. Given the history as to how Formato went about forming these companies, and how each of the applicants came to rise through the ranks and obtain a minority shareholding, as described earlier in this judgment, the applicants, quite fairly, do not seek to make out such a case.[8]

32. A further difficulty in granting the relief under section 163 is whether it is just and equitable to do so. As appears above,[9] this is one of the jurisdictional requirements for such relief to be granted

33. As has been described by Formato in his answering affidavit, effectively on an undisputed basis and as set out above, there were at the very least swings and roundabouts that resulted from Supreme Mouldings giving of financial assistance, irregular as it may have been. Assuming in favour of the applicants that the giving of financial assistance did have some or other negative effect on Supreme Mouldings in that it exposed Supreme Mouldings to financial risks it would not otherwise have been exposed to at the instance of the bank if the bank called upon the guarantee and security cession, Supreme Mouldings did have the upsides as described

[8] Distinguishing many of the well-known cases in this area of law relating to small domestic companies or quasi-partnerships where there is a legitimate expectation that the minority shareholder would participate in the management of the company, and so where the exclusion of that minority shareholder may be unfairly prejudicial: see the discussion in *De Sousa* above, 44 to 48, and the cases there cited.

[9] *Louw v Nel,* para 23.

above. The impugned conduct took place in 2018, before the Covid-19 pandemic. Formato has described how the financing that was facilitated by the financial assistance, irregular as it may have been, provided a source of funds that enabled Supreme Mouldings as the operating company to see its way through the Covid-19 pandemic in 2020, and its lingering effects. The applicants continue to reap the benefit of the operating company having survived Covid-19 through their minority shareholding in the holding company, which in turn owns Supreme Mouldings. When it comes to assessing whether it is just and equitable to grant the relief, a wider commercial view must be taken which recognises both the upsides and downsides that resulted from the irregular transactions of which the applicants complain.

34. The respondents and Formato have since, in 2022, taken steps to and have passed resolutions ratifying the previous transactions in relation to the financial assistance that as was otherwise irregularly given. The applicants argue that this does not change the consequences of those actions, at least in relation to their contended for prejudicial effect in causing a diminution in the value of the applicants' shareholding in the holding company. I have already found though that the irregular transactions did not prejudicially affect the applicant's interests, and rather sustained value within the group. Nevertheless, as submitted by the applicants, ratification is not a directly relevant issue,[10] although to a some

[10] And so unnecessary to decide whether the irregular financial assistance could be ratified retrospectively. Nor need it be considered whether there could have been a diminution in value if the transactions were treated as

extent it may reinforce an argument that as the irregularity has been addressed, there is less need for relief to be granted from a just and equitable perspective.[11]

35. Of course, the conduct of Formato in relation to the irregularity of the adoption of the various resolutions relating to the financial assistance must be deprecated. The applicants, had they not given up their shareholding in Supreme Mouldings and/or had they retained their directorship in Supreme Mouldings, may have had some form or recourse available to them to address the impugned conduct which took place at the level of Supreme Mouldings. But insofar as they have sought to claim relief as minority shareholders in the holding company Investments based upon section 163 of the Companies Act, I am unable to find that Supreme Mouldings, as a related person through Formato, has conducted itself in a manner that is oppressive and/or unfairly prejudicial to the applicants in the manner that they have described (i.e. a diminution in the value of their shareholding in Investments) or that it would be just and equitable for the relief that they seek to be granted.

36. As the applicants have not succeeded in their application, it follows, in my view, that they should be responsible for the costs of the application.

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void in terms of section 45(6) of the Companies Act, and so Supreme Mouldings not bound by the guarantee and security cession. In any event, the latter is not an issue that arose during the course of the argument.

[11] Contrast to *Grancy Property Ltd v Manala and Others* 2015 (3) SA 313 (SCA), para 36, where the directors made no demonstrable attempt to meaningfully address the irregularities.

37. The application is dismissed, the applicants to pay the costs, jointly and severally.

Gilbert AJ

Date of hearing:	10 May 2023
Date of judgment:	5 June 2023
Counsel for the applicants:	Adv G V Meijers
Instructed by:	Louw Louw Inc
Representative for the respondents:	K J van Huyssteen (Attorney) Fluxmans Attorneys