Republic of South Africa

IN THE HIGH COURT OF SOUTH AFRICA
(WESTERN CAPE DIVISION, CAPE TOWN)

Case No: 17199/2016

Before: The Hon. Mr Justice Binns-Ward
Hearing: 10 November 2016
Judgment: 15 November 2016

In the matter between:

LEWIS GROUP LIMITED Applicant

and

DAVID FARRING WOOLLAM First Respondent
JOHAN ENSLIN Second Respondent
LESLIE ALAN DAVIES Third Respondent
DAVID MORRIS NUREK Fourth Respondent
HILTON SAVEN Fifth Respondent

(This judgment should be cited as *Lewis Group Limited v Woollam and Others* (2) to distinguish it from the judgment in *Lewis Group Limited v Woollam and Others* [2016] ZAWCHC 130 (11 October 2016.)

JUDGMENT

BINNS-WARD J:

[1] The matters for determination at this stage arise from two interlocutory applications that are incidental to the principal proceedings in which Lewis Group Limited ('Lewis') has applied in terms of s 165(3) of the Companies Act 71 of 2008 for an order setting aside a demand made on it by one David Woollam ('Woollam') in terms of s 165(2) to institute proceedings in terms of s 162 of the Act to have four of the company's directors declared to be delinquent directors.

[2] Woollam has applied in the first of the aforementioned interlocutory applications for an order:

1. That the rules pertaining to discovery shall apply in the principal application insofar as the court might direct in terms of rule 35(13) of the Uniform Rules of Court;
2. That Lewis be ordered to make discovery within 20 days of the report titled '*Report description: Accounts Cancelled / Re-invoiced*' for each of the 760 branches of the company's trading subsidiary (Lewis Stores (Pty) Ltd.) for the period 15 January to 30 March 2016;
3. That Woollam be allowed to deliver his answering affidavit 15 days after 'receipt' of the reports discovered in terms of para. 2;
4. Costs only in the event of the interlocutory application being opposed, otherwise that costs be costs in the principal application.

[3] In the second interlocutory application, Lewis has applied by way of a counter-application for an order directing Woollam to deliver his answering papers in the principal application within five days. In argument, however, Lewis's counsel moderated that demand to afford Woollam 10 days' grace in order to accommodate the reported exigencies of Woollam's counsel's other commitments. It is undisputed that Lewis would be entitled to an order in terms of its counter-application in the event of Woollam's application for discovery not being granted.

[4] Rule 35, which regulates the discovery procedure in general civil litigation, is primarily applicable in action proceedings. Rule 35(13) provides, however, that '*The provisions of this rule relating to discovery shall mutatis mutandis apply, in so far as the court may direct, to applications*'. The fact that, differently to the position in respect of actions, a party seeking discovery in motion proceedings is able to obtain it only insofar as the court might direct points to the availability of the procedure in applications as being out of the ordinary, and, to that extent, exceptional. Indeed, in *Moulded Components and Rotomoulding South Africa (Pty) Ltd v Coucourakis* 1979 (2) SA 457 (W) at 470D-E, Botha J remarked '*In application proceedings we know that discovery is a very, very rare and unusual procedure to be used and I have no doubt that that is a sound practice and it is only in exceptional circumstances, in my view, that discovery should be ordered in application proceedings*'.

[5] In *Moulded Components* the learned judge declined the request to make the procedure applicable for a number of reasons, including the failure of the party seeking discovery to have sought the documents concerned earlier, the danger that acceding to the request could lead to an unwholesome widening of the ambit of the proceedings, the limited relevance of the documents sought, the wide form in which the relief was sought and the court's perception that the contemplated exercise would be something of a 'fishing expedition'. The court's reasoning confirms that the determination of an application for discovery in motion proceedings proceeds upon an examination of the request with reference to its particular content[1] assessed in the context of the peculiar characteristics of the litigation and mindful of the premise that the request should, as a matter of policy, be granted only exceptionally.

[6] The pertinent principles have been rehearsed in a number of other reported judgments, notably *Saunders Valve Co Ltd v Insamcor (Pty) Ltd* 1985 (1) SA 146 (T), *Premier Freight (Pty) Ltd v Breathetex Corporation (Pty) Ltd* 2003 (6) SA 190 (SE), *STT Sales (Pty) Ltd v Fourie 2010* (6) SA 272 (GSJ) and *FirstRand Bank Ltd t/a Wesbank v Manhattan Operations (Pty) Ltd* 2013 (5) SA 238 (GSJ). It seems to me that the essential criterion is whether discovery would be material to the proper conduct and fair determination of the case.

[7] Consistently with the very existence of the sub-rule, the jurisprudence recognises that in appropriate circumstances there is scope for discovery to be directed in motion proceedings; see e.g. *Premier Freight* and *Saunders Valve* supra. In the peculiar context of the case in *Saunders Valve*, for example, the court considered that the applicant's election to proceed on motion for relief that ordinarily would have been sought in action proceedings had prejudiced the respondent's ability to properly advance the evidential aspects of its defence, as it would have been able to do in a trial after discovery had been made, and therefore directed the applicant to make discovery before the respondent delivered its answering papers. Broadly similar considerations led the court to make a comparable order in *Premier Freight*. Those considerations plainly find no application in the current matter in which the use of motion proceedings in the principal case are prescribed by the Act. In *The MV Urgup: Owners of the MV Urgup v Western Bulk Carriers (Australia) (Pty) Ltd and*

[1] The request might be wide-ranging as in a general request for discovery of the nature made in the ordinary course in action proceedings in terms of rule 35(1), or more confined, and directed at making the provisions of the rule applicable only in respect of particularised material, as in the current case.

Others 1999 (3) SA 500 (C), by contrast, an application for discovery in motion proceedings was dismissed, amongst various reasons because it was sought in proceedings that were only incidental to the principal proceedings between the parties. Thring J made the following observations in that respect (at p.513H-I) '*Discovery has been said to rank with cross-examination as one of the two mightiest engines for the exposure of the truth ever to have been devised in the Anglo-Saxon family of legal systems. Properly employed where its use is called for it can be, and often is, a devastating tool. But it must not be abused or called in aid lightly in situations for which it was not designed or it will lose its edge and become debased. It seems to me that, generally speaking, its employment should be confined to cases where parties are properly before the Court and are litigating at full stretch, so to speak. It is not intended to be used as a sniping weapon in preliminary skirmishes, such as the main application in this matter is, unless there are exceptional circumstances present*'.

[8] Turning then on the basis of those principles to consider whether discovery as requested by Woollam should be directed in the circumstances of the principal application in the current matter. The demand served on Lewis was based in material part on the allegation by Woollam that Lewis was artificially improving 'the quality of its debtors book experience' by use of a practice whereby executory credit transactions were cancelled and re-invoiced as cash transactions. Woollam maintains that the practice enables Lewis to put up a misleading basis for its bad debt provisions and expected future cash flows and alleges that 'it is nothing other than accounting fraud'. He claims that the directors he wants the company to have declared delinquent were privy to the allegedly fraudulent conduct. His allegations were founded on information relayed to him by an employee of Lewis Stores (Pty) Ltd, one Leon Mocke. Mocke confirmed the content of his report to Woollam in an affidavit dated 15 August 2016. Mocke testified that each branch prepared reports titled '*Report description: Accounts Cancelled / Re-invoiced*', which were submitted to the group head office to be processed there in the context of a biennial writing-off exercise routinely conducted as part of the group's accounting management.

[9] An example of such a report in respect of the Saldanha branch that was in the papers was considered during the course of argument. It sets out on an itemised basis the accounts at the branch that were cancelled during a given period and the amounts

involved. It bears out that some cancelled credit transactions were converted to cash transactions at given values.

[10] In its founding papers in the principal application Lewis has admitted the practice referred to by Woollam and set out an explanation of its operation and effect. The imputation of accounting fraud was rejected as unfounded. Lewis has also put in a report from an independent firm of accountants and auditors, KPMG, in which, predicated on a limited sampling exercise, the practice was evaluated and commented upon, more particularly, whether the process of cancellation and re-invoicing of one account impacts on the projected cash flows for other accounts. KPMG's report is highly technical, and subject to a number of possibly material qualifications, but insofar as I have been able to understand it, appears to opine that the system of cancellation and re-invoicing used by Lewis for preparing its consolidated financial statements is applied logically and consistently with the system explained in the affidavit of Morné Mostert, General Manager: Finance for Lewis Stores (Pty) Ltd, jurat 12 September 2016. Mostert has dealt in summary with the effect of the practice at paragraphs 14 and 15 of his affidavit. It does not seem to me that Woollam would require access to all the branch reports to answer Mostert's explanation. Whether the system is technically good or bad, insofar as it affect's Lewis's reporting in respect of bad debt provision and future cash flows, is not really relevant to the enquiry whether Woollam's demand is without merit. The central enquiry in that regard has to be whether Woollam's demand, assessed in the context of the evidence in the application in terms of s 165(3), has made out a cognisable claim for a declaration of delinquency on the grounds set forth in s 162(5)(c) of the Companies Act; viz. that the directors in question grossly abused their position as directors, took personal advantage of information or an opportunity, contrary to section 76(2)(a) of the Act, intentionally or by gross negligence inflicted harm on the company contrary to s 76(2)(a) or acted in a manner that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the director's functions within, and duties to, the company; or contemplated in section 77 (3)(a)(b) or (c) of the Act.

[11] Lewis has admitted that certain of its employees had made themselves guilty of misconduct by abusing the cancellation and re-invoicing policy. It pointed to disciplinary action that had been taken against some employees in this respect prior to Woollam first having raised any concerns on the point. The only possible relevance

of that evidence appears to be to support an argument that it shows conduct by the company inconsistent with any fraudulent complicity by any of its directors in the abuses. The content of the reports does not appear to bear on this aspect either.

[12] Woollam avers that if all the branch reports were made available they would either provide 'a full and compelling answer to [his] allegations' or confirm that there was indeed widespread abuse. He maintains that this requires that he must be afforded access to all the reports to consider his position before filing his answering papers. He says that they 'may prove to be fatal to [his] demand in terms of Section 165(2) or these reports may provide such demand with additional impetus'.

[13] Regard being had to the principles rehearsed earlier, it is important to categorise the character of the proceedings in the principal case, which, it will be recalled, is an application in terms of s 165(3) of the Companies Act. The subsection provides: '*A company that has been served with a demand in terms of subsection (2) may apply within 15 business days to a court to set aside the demand only on the grounds that it is frivolous, vexatious or without merit*'. It is clear that the bases upon which a company can impugn a demand made on it in terms s 165(2) are strictly limited. The only one that could possibly be relevant in respect of Woollam's request for discovery would that pertaining to the question of the demand being 'without merit'. Indeed, it is evident from the extracts from his supporting affidavit in the interlocutory application quoted earlier that the object that Woollam seeks to achieve through discovery is to establish, at least in his own mind, whether his demand is factually well founded or not, and in particular whether the practice gives rise to a material misstatement of Lewis's financial condition. But that is not what the principal proceedings are concerned with. Woollam's objective is therefore quite irrelevant for the purposes of the principal proceedings.

[14] When a court considers, for the purposes of deciding an application in terms of s 165(3), whether a demand is without merit, it does not pre-empt the determination of the claim that the demander is intending to prosecute derivatively if the company does not comply with the demand, nor is it concerned with the prospects of success of that claim; cf. *Amdocs SA Joint Enterprise (Pty) Ltd v Kwezi Technologies (Pty) Ltd* 2014 (5) SA 532 (GJ), at para.s 14-17, and *Lewis Group Limited v Woollam and Others* [2016] ZAWCHC 130 (11 October 2016), at para.s 53-56. When a court assesses the demand in the context of the evidence

adduced in the application, it does so merely to ascertain whether the demand has made out a cognisable basis for the contemplated derivative action. In a sense the exercise is akin in material respects (but not identical) to that which a court adopts when determining an exception to a pleading. The evidence that the court takes into account in an application in terms of s 165(3) is relevant only to the extent that it enables the court to assess whether or not the subject matter of the demand can be sustained in the contemplated derivative action. The demand will not be found to be without merit if, assessed in the context of the evidence, its content makes out a cognisable claim that on its face would be triable. The prospects of success of the remedy contended for in the demand on the other hand, and the viability of pursuing it, as well as whether it would be in the best interests of the company to do so, are the subject matter of the investigation contemplated in terms of s 165(4) and any subsequent application that might be brought in terms of s 165(5). Those steps in the statutory derivative action process are discrete from that provided for in terms of s 165(3); cf. *Lewis Group* supra, at para.s 89-92.

[15] In the principal case, Lewis has to show that Woollam's demand, assessed in the context of the evidence taken on its face, does not make out a prima facie case of conduct by the allegedly delinquent directors of the sort described in s 162(5)(c) of the Companies Act;[2] alternatively, if it does, that it is able to unanswerably rebut it. In other words, it must show that there is nothing in the demand that merits being the subject of the prescribed investigation or the proposed derivative action. The declared object of the discovery sought by Woollam goes rather towards demonstrating the prospects of success, alternatively the lack thereof, of establishing the allegations he has made of accounting fraud to found the derivative action he would wish to pursue if the company does not do so on its own initiative. That is an irrelevant question for

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[2] Section 162(5)(c) provides:

A court must make an order declaring a person to be a delinquent director if the person-

(c) while a director-

(i) grossly abused the position of director;

(ii) took personal advantage of information or an opportunity, contrary to section 76 (2) (a);

(iii) intentionally, or by gross negligence, inflicted harm upon the company or a subsidiary of the company, contrary to section 76 (2) (a);

(iv) acted in a manner-

(aa) that amounted to gross negligence, wilful misconduct or breach of trust in relation to the performance of the director's functions within, and duties to, the company; or

(bb) contemplated in section 77 (3) (a), (b) or (c).

the purposes of determining the application by Lewis in terms of s 165(3) of the Companies Act. He is not prejudiced for present purposes by not having the other reports. If Lewis chooses not to make them available, it does not stop Woollam from extrapolating the information he has in the reports that are available to him for the purpose of explaining the basis for his demand. Lewis has not suggested that the report in respect of the Saldanha branch is conceptually distinguishable from the reports it would have received from the other branches. If Woollam considered that access to all the reports was necessary to determine whether he could make out a cognisable case for the company to pursue proceedings in terms of s 162 against the four directors (as to which I express no opinion), he could and should have sought it before making the demand.

[16] Woollam has therefore failed to make out a case for the court to exercise its discretion in favour of making an order in terms of rule 35(13) that there should be discovery in the application in terms of s 165(3), at least at this stage.

[17] It follows that Woollam's interlocutory application must be dismissed and Lewis's counter-application granted.

[18] The following orders are made:

1. The application by the first respondent (Woollam) for a direction in terms of rule 35(13) is dismissed.
2. The first respondent is directed to deliver his answering papers in the principal case within 10 days of the date of this order, failing which the applicant (Lewis) may enrol the application in terms of s 165(3) of the Companies Act 71 of 2008 for hearing as an unopposed application.
3. The first respondent shall pay the applicant's costs of suit in the interlocutory applications, including the costs of two counsel.

A.G. BINNS-WARD
Judge of the High Court

APPEARANCES

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