

SOUTH AFRICA / JUDGMENT

Roestorf NO and Another v Johns (12036/07) [2012] ZAKZDHC 48 (28 August 2012)

[2012] ZAKZDHC 48

COURT

Kwazulu-Natal High Court, Durban

BEFORE

Lopes

CASE / FILE NUMBER

12036/07

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In the KwaZulu-Natal High Court, Durban

Republic of South Africa

Case No : 12036/07

In the matter between :

Jan J Roestorf NOFirst Plaintiff

David G Walshe NOSecond Plaintiff

and

Katherine Natalie JohnsDefendant

Judgment

Lopes J

[1] The plaintiffs in this matter sued the defendant for payment of the sum of R2 742 521,35 being damages sustained by the plaintiffs when their shares and loan accounts in a company in which they were shareholders together with the defendant were destroyed. I heard the evidence of five witnesses and the plaintiff thereafter closed its case. The defendant now seeks absolution from the instance.

[2] The history of the parties insofar as it is relevant may be described as follows :

- (a) Jan J Roestorf and David G Walshe have been business partners for many years. They conduct their business ventures via the vehicle of two family trusts one of which is the Jan Roestorf Formax Trust, and the other is the David Walshe Formax Trust. Mr Roestorf and Mr Walshe are each a trustee in both trusts. The two trusts are the plaintiffs in this action.
- (b) As a result of Mr Rostorf's interest in motor cycles, during 2002 the two family trusts became shareholders in a close corporation which later became Two Wheel Investments (Pty) Limited which traded as Tommy Johns Motorcycles ('Tommy Johns Motorcycles') in Old Main Road in Pinetown. Tommy Johns had acquired significant status as a motor cyclist, and Mr Roestorf paid frequent visits to Tommy Johns Motorcycles and discussed the conduct of the business with Tommy Johns. Mr Walshe, on the other hand, was very much a sleeping partner who had no knowledge of, nor interest in, motor cycles at the time that the family trusts

became shareholders.

- (c) Matters continued until the unfortunate and untimely death of Tommy Johns in January 2004 in a motor cycling accident. Tommy Johns Motorcycles was then left in the uncomfortable position that it had no leader and no dealer principal for the BMW motorcycles which it then traded.
- (d) Mr Roestorf then agreed to involve the daughter of Tommy Johns in the business. She is Katherine Natalie Johns, the defendant in this action. He saw this as a way of preserving the name and legacy of Tommy Johns, and of giving the defendant an opportunity to grow her business acumen and fulfil the role of dealer principal and the position of someone who was on hand to run the business.
- (e) Negotiations were conducted and on the 2nd April of 2004 the defendant signed a contract of employment with Tommy Johns Motorcycles. Things went well for approximately the first 18 months, whereafter the business went into such a steep decline that it was eventually closed and liquidated in

2007. The plaintiffs lay the blame for the failure of the business at the feet of the defendant, and now seek to claim from her the sum of

R2 742 521,35 being damages sustained by the trusts for the loss of their shares and loan accounts in the company consequent upon its liquidation.

- [3] In the particulars of claim it is alleged that the defendant, as an agent of the company, acted mala fide, alternatively fraudulently, alternatively negligently, resulting in the cancellation of the dealership arrangements concluded with Kawasaki and BMW Motorcycles. As a result of the cancellation of those dealerships Tommy Johns Motorcycles ceased business on the 15th April 2007. The shares of the plaintiffs have no residual commercial value and it is common cause that the company was liquidated after this action was instituted.

- [4] The plaintiffs called five witnesses. For the purpose of this judgment it is only necessary for me to summarise their evidence in the briefest possible terms as follows :

Christopher Speight was the managing director of KMSA Distributors (Pty) Ltd, the importer and distributor of Kawasaki motor cycles throughout South Africa. That company concluded a dealership agreement with Tommy Johns Motorcycles which it subsequently cancelled, because of the conduct of the defendant. Her conduct was described by Mr Speight as being fraudulent and leaving him with no other option than to cancel the contract as every vestige of trust was gone.

Lachlan Harris was the general manager of BMW Motorcycles, a division of BMW SA, the importer and distributor of BMW motorcycles in South Africa. BMW Motorcycles had similarly concluded a distributorship agreement with Tommy Johns Motorcycles. Mr Harris stated that the agreement was cancelled by BMW, also because of the conduct of the defendant, as a result of what was described as a breach by her of a relationship based on trust.

Deon Botha was a chartered accountant and director of Anderson Rocussen van der Bijl Inc. He testified that the value of the plaintiffs' shareholdings in Tommy Johns Motorcycles had been reduced to zero from their original value of R350 000, and that their loan accounts had been rendered nugatory by the close of the business.

Mr Roestorf gave evidence as to his relationship with Tommy Johns leading up to his involvement in the business. He and Mr Walshe became shareholders in Tommy Johns Motorcycles via the vehicle of their family trusts. He testified to the breakdown of the relationships which existed between Tommy Johns Motorcycles, KMSA Distributors (Pty) Ltd and BMW SA. He also spoke to his efforts to attempt to save the business.

Mr Walshe gave evidence as to how he had eventually become involved in trying to save the business because Mr Roestorf was in Australia and unable to be present at the business in order to attempt to turn things around.

- [5] Mr Harrison who appears for the defendant now applies for absolution from the instance. He does so on two bases :

that the rule in *Foss v Harbottle* [1843] EngR 478; (1843) 2 Hare 461 (67 ER 189) dictates that the correct person to have sued for the loss of the plaintiffs' shares and loan accounts was the company itself and not the shareholders; and

that on the facts there is no evidence on which a court could or might find in favour of the plaintiffs.

- [6] The rule in *Foss v Harbottle* was summarised in *Prudential Assurance Co Ltd v Newman Industries Ltd and Others (No 2)* [1982] CH 204 at 210 F – 211 A as follows :

‘The classic definition of the rule in *Foss v Harbottle* is stated in the judgment of Jenkins L.J. in *Edwards v Halliwell* [1950] 2 All E.R. 1064 as follows. (1) The proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is, *prima facie*, the corporation. (2) Where the alleged wrong is a transaction which might be made binding on the corporation and on all its members

by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of that

matter because, if the majority confirms the transaction, *cedit quaestio*; or, if the majority challenges the transaction, there is no valid reason why the company should not sue. (3) There is no room for the operation of the rule if the alleged wrong is *ultra vires* the corporation, because the majority of members cannot confirm the transaction. (4) There is also no room for the operation of the rule if the transaction complained of could be validly done or sanctioned only by a special resolution or the like, because a simple majority cannot confirm a transaction which requires the concurrence of a greater majority. (5) There is an exception to the rule where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders’ action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.’

[7] The rule was considered in a number of South African cases. In *McLelland v Hulett and Others* 1992 (1) SA 456 (D) Booysen J considered the application of the rule in circumstances where the plaintiff, a 10% shareholder, sued for a loss suffered by the company as a result of the failure of the majority shareholders and directors to conclude a particular transaction. The plaintiff’s loss was easily ascertainable as a percentage of the loss to the company as a result of the failure to conclude the transaction.

[8] Dealing with the rule in *Foss v Harbottle*, Booysen J stated at page 466D :

‘Whilst it is accepted that, generally, a shareholder’s rights are defined with respect to the company which is interposed as a barrier between the shareholder and the commerce in which the company is involved, this view is too narrow in the present context. A reliance on this “technical” status of a shareholder ought not to be allowed as a matter of policy, whether one is examining the enquiry as to (a) the existence of a legal duty in a delictual claim such as this; or (b) the applicability of the rule in *Foss v Harbottle* (*supra*).’

[9] At page 467B-H Booysen J continued :

‘The rule in *Foss v Harbottle* is not an absolute rule ... Whilst it is clear that the primary rule that a company must sue for a loss such as that in question in this case, and not the shareholder, is a logical reflection of the concept of limited liability, in practice the real reason why the rule must exist is linked more fundamentally to the separate existence of the company, with the result that, if the shareholder is allowed to sue, any wrongdoer will be subject to “double jeopardy”.

Where, as in the present case, that risk is non-existent and a shareholder is left with a diminished patrimony, the continued application of the rule would amount to an unwarranted and technical obstruction to the course of justice. There is no basis for saying that the rule in *Foss v Harbottle* has been received into our law without the exceptions together with which it is framed. Having regard to the peculiar facts in this case, I take the view that that aspect of the rule which requires the relief to be sought for the company does not apply.'

[10] McLelland is distinguishable from the present matter because :

in McLelland a 10% minority shareholder was suing the defendants who held the majority of the shares between them, and they could effectively therefore have blocked any attempt by McLelland to persuade the company to institute an action to recover its losses;

the action in McLelland was apparently instituted well after the liquidation of the company, as the resolution to wind-up the company was dated the 20th April 1988, and the case number according to the case register is 3761/89.

[11] In the present matter the facts are somewhat different. It is the majority shareholders, holding 75% of the shares who wish to recover the loss in the value of their shares and their loan accounts from the 25% minority shareholder. There is no reason why they could not have passed a resolution authorising the action on behalf of the company to recover the losses sustained by the company as a result of the actions of the defendant.

[12] In addition to the foregoing, it is common cause that the action was instituted before the liquidation of the company. In their evidence both Mr Roestorf and Mr Walshe confirmed that they have had no contact with the liquidators of the company. What is clear is that no attempt was made by them to pursue any avenue on behalf of the company against the defendant.

[13] With regard to the possibility of 'double jeopardy' it was submitted by Mr Shepstone who appeared on behalf of the plaintiffs that, given the lapse of time, there was no possibility of the institution of any action

against the defendant by the liquidators. But with no information before me with regard to the conduct of the liquidators or their

intentions to recover any amount from the defendant, a decision one way or the other would be speculation on my part. It was incumbent on the plaintiffs to demonstrate that they are the proper plaintiffs in this action. They have not led any evidence to deal with the concept of 'double jeopardy'.

[14] I am also alive to the fact that there are a finite number of possible plaintiffs in this action and that the relationship between the shareholders may be viewed as one akin to a partnership. All that, however, does not detract from the fact that the bringing of the action by the plaintiffs was in breach of the rule in *Foss v Harbottle*.

[15] Mr Shepstone submitted the following :

The rule in *Foss v Harbottle* relates generally to derivative actions and this is not a derivative action. That is so, but to rule solely on that basis would be to ignore the principal proposition in the rule that where a wrong is done to a corporation, *prima facie* the corporation is the proper plaintiff in any action.

That the rule in *Foss v Harbottle* is not an absolute rule. In this regard Mr Shepstone relied on the dicta of Booysen J in *McLelland* at 467 H that the continued application of the rule, where a shareholder is left with a diminished patrimony, would amount to an unwarranted and technical obstruction to the course of justice. That is not the case here because the plaintiffs had every opportunity to authorise the company to institute an action. They could also have liaised with the liquidators of the company to ensure that, for example, an action in terms of s 424 of the Companies Act, 1973 was instituted. They chose not to do so but instead instituted this action even prior to the liquidation of the company.

[16] I accept without question that the plaintiffs had a financial interest in the business of the company. But the fact that their shareholding was affected by the conduct of the defendant does not give them a right of action *per se* against the defendant. In my view they have not demonstrated that this action falls outside the rule, or within any of the exceptions envisaged in *Foss v Harbottle*.

[17] The application for absolution must therefore prevail.

[18] Aside from the rule in *Foss v Harbottle*, there would appear to be a further reason why it is wrong to allow an action to be brought by the plaintiffs. The reason is given by Richard R Lee (1957) 35 North Carolina LR 279 – 284 :

‘The real objection to permitting a shareholder to recover directly for his proportionate share of the damage inflicted upon the corporation of which he is a member is not that the injury was done to the corporate entity rather than to him, but that the result of such recovery is a return of corporation assets to shareholders without first satisfying corporate creditors.’

[19] Without any evidence with regard to the liquidation of Tommy Johns Motorcycles, it is impossible to say whether or not all creditors were paid, or whether or not there was a dividend remaining to be paid to the shareholders, a factor which could have affected the plaintiff’s quantum of damages. If the action lies in the first instance in the hands of the company, then if all the creditors were not paid, any amount recovered by the company could have gone to the creditors who suffered a shortfall. To allow the present action would be to circumvent the liquidation process in its entirety and award a dividend to shareholders which, on the full facts of the matter had they been known to me, may not have been warranted.

[20] With regard to the question of costs, there is no reason why the costs should not follow the result. I would, in any event and in the exercise of my discretion to award of costs, order the plaintiff to pay the defendant's costs.

[21] I accordingly make the following order :

- (a) The defendant is absolved from the instance.
- (b) The plaintiffs are to pay the defendant's costs of suit.

Date of hearing : 18th June 2012

Date of judgment : 28th June 2012

Counsel for the plaintiffs : Mr Shepstone (instructed by Shepstone & Wylie)

Counsel for the defendant : G Harrison (instructed by Thorpe & Hands Inc)

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