In re:

CHOPPIES ENTERPRISES LIMITED

OPINION FROM COUNSEL ON CORPORATE GOVERNANCE

Table of Contents

Introduction and summary of advice

1. We have been instructed by Neill Armstrong Attorneys, on behalf of Choppies Enterprises Limited (referred to variously as ***"CEL***", "***Choppies***" or "***the Company***"), to provide our opinion on various aspects of the Company's corporate governance both before and after the suspension of its trading on the Botswana and Johannesburg stock exchanges in November 2018.

2. In particular we have been asked to consider the events that gave rise to the suspension of trading and advise on whether the Company's directors, (primarily its CEO Mr Ramachandran Ottapathu ("***Ottapathu***")), properly executed their fiduciary duties and upheld the principles of good corporate governance.

3. The catalyst for the suspension was audit queries raised by the Company's auditors, Price Waterhouse Coopers ("***PwC***"). The auditors were concerned about alleged/apparent stock losses which were disguised; as well as the Company's and Ottapathu's alleged improper relationship with a buying entity known as the Fours Buying Group.

4. Our opinion is based on documentary evidence provided to us by our instructing attorney (in particular reports from the Desai Law Group ("***DLG***") and Ernst & Young Advisory Services (Pty) Ltd ("***EY***")). As we shall explain in some detail below, much of the evidence that underlies these reports is disputed and has not been tested fully; and Ottapathu has not been given a proper opportunity of rebuttal. However, there is sufficient information (some of it undisputed) to draw a number of *prima facie* conclusions, and to enable us to comment on aspects of the Company's corporate governance which might have been inadequate.

5. We must stress that we have not undertaken the in-depth investigations that DLG and EY carried out. We are reliant, for our conclusions, upon what is contained in their reports as well as preliminary rebuttals of their conclusions that we have been furnished with. That said, we are reasonably confident in the views expressed in this opinion.

6. At the outset we should point out that CEL is the group holding company. Trading operations are carried on by its wholly owned subsidiary Choppies Distribution Centre (Pty) Ltd ("***CDC***"). It is clear from our instructions and from the documents that we have perused, that, by and large, the group ignored the distinction between the holding company and the trading subsidiary and that the board of CEL effectively ran the affairs of CDC.[1]

7. In this opinion we conclude that there have been several failures of corporate governance. In our view, none of these failures (with one exception) appears to be so egregious as to warrant civil or criminal action being taken against the directors involved. Rather, it seems to us that these failures may be used as a learning opportunity to improve the Company's internal controls and governance procedures.[2]

8. Put simply, the previous board of directors ("***the board***") gave Ottapathu (who is the largest single shareholder in CEL and has at all times been a director of the Company) far too much autonomy and power to run the Company without proper oversight. This resulted in a number of corporate governance shortcomings.

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1 As we point out later, the running of the business was, until recently, left by the board, almost entirely, in the hands of Ottapathu. No point seems to have been made of this blurring of corporate identities and we shall take it no further. Suffice it to say that this appears to have been recognised and that steps have been taken to correct this anomaly.

2 We point out that we were informed by Mr Tom Pritchard in consultation that a comprehensive overhaul of corporate governance has taken place subsequent to the appointment of a new board at an extraordinary general meeting of the company held in September 2019.

9. It is a central tenet of good corporate governance that the board should govern its company effectively. This has not happened. Ottapathu seems to have been permitted, largely, to run the Company as his own personal fiefdom. We do not presume to express an opinion on whether or not he has done a good job overall; that is for the shareholders to decide. However, the Botswana Companies Act[3] ("***the Act***") requires adherence to the principles of good corporate governance as expressed in the King IV Report[4] and enshrined in Part X of the Act. There have been several shortcomings in this respect.

10. This has now been recognised and we are instructed that reforms have been made to ensure that Ottapathu, and whoever might eventually succeed him as CEO, is not given free rein to run the Company without proper oversight from the board.

11. The exception referred to in paragraph 7 above pertains to allegations of stock losses in South Africa and Zimbabwe and, more worrying, the possibility that up to R200 million worth of stock loss has been fraudulently hidden from the Company's board and its shareholders.[5] Whilst we cannot say with any certainty that such a fraud has indeed been perpetrated, in our view, a *prima facie* case, set out in detail in the EY report, has been established. This bears full investigation.

12. In addition, we recommend that further investigation be done into various non-disclosures of outside interests by some of the Company's directors. If these non-disclosures reveal conflicts of interest then it may become necessary, depending on the extent of these conflicts and the action taken by the directors concerned, to institute civil action.

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3 Cap 42:01

4 The King IV Report on Corporate Governance for South Africa, 2016

5 The allegation pertains to R130 million worth of stock in South Africa, and $6 million worth of stock in Zimbabwe

13. In sum, on the evidence available to us, we are satisfied that there has been no actionable malfeasance by Ottapathu in relation to the Fours Buying Group (save for his contribution to certain failures of good corporate governance). However, if further evidence comes to light, a re-evaluation of this assessment may be warranted.

14. As we have said, our primary concern is that, in our view, a *prima facie* case of the fraudulent disguising of stock losses[6] has, at the very least, been established. We therefore recommend that further investigations be conducted.

15. It is beyond the scope of this opinion to recommend whether certain Choppies employees should be investigated or held to account for possible fraud. Mr Andrew Redding SC with Mr Meyerowitz have been briefed to consider whether any misconduct may have been committed by any Choppies employees under labour law; and what process should be followed if that is indeed the case. A recommendation, if any, will come from him.

Factual context of opinion

16. The factual context of this opinion may be summarised as follows:

16.1. In February 2018 PwC was appointed as external auditor for the Company's financial year-end in June 2018.

16.2. In early March 2018 the Company's audit committee identified possible discrepancies in reported stock levels across its stores in South Africa and Zimbabwe. Soon thereafter, the board resolved that management and PwC would conduct a stock count to commence on 7 April 2018.

[6] With a concomitant manipulation of the results of CDC's trading activities.

16.3. Prior to the stock count, and for the most part over the course of the Easter weekend, the Company's executive management purportedly sold off significant amounts of bulk stock in both South Africa and Zimbabwe (to the value of approximately R130 million and US$6 million, respectively) – referred to hereafter as "***the bulk sales***".

16.4. While compiling the Company's audited financial statements for the financial year-end on 30 June 2018 ("***the 2018 AFS***"); PwC raised concerns about, *inter alia*:

16.4.1. the reporting used for indicating stock levels in the South African and Zimbabwean stores;

16.4.2. the purported sale of the bulk stock to a company Devland Cash and Carry (Pty) Ltd ("***Devland***");

16.4.3. the purchase by CDC of four South African stores from ANE Western Cape (Pty) Ltd ("***ANE***"), a company associated with Devland;

16.4.4. CDC's involvement and financing of the Fours Buying Group; *and*

16.4.5. the acquisition by Ottapathu of a 50% shareholding in the companies that made up the Fours Buying Group.

16.5. As a result of these concerns (which could not be addressed to PwC's satisfaction), Choppies was unable to publish its financial results for the 2018 year-end timeously; and it was eventually suspended from trading on both the Botswana and Johannesburg stock exchanges in November 2018.

16.6. In May 2019 the Board suspended Ottapathu pending a disciplinary hearing into allegations of misconduct pertaining some of the concerns raised by PWC. Ottapathu challenged the legality of his suspension in court and it would appear that these proceedings are still pending.[7]

16.7. On 3 June 2019 the board received a report compiled for it by DLG pertaining to, *inter alia*, allegations of financial mismanagement by the Company regarding the Fours Buying Group and one of that group's member companies, Pay-less Supermarket (Pty) Ltd ("***Payless***"). In that report ("***the DLG report***") DLG recommended that, *inter alia,* the board should:

16.7.1. reflect on its own collective responsibility for the lack of corporate oversight;

16.7.2. contemplate disciplinary action against Ottapathu for an apparent breach of an undertaking given to the Botswanan Competition Authority ("***the CA***") by CDC and the Fours Group to disentangle/terminate its buying arrangement ("***the disentanglement allegation***"); *and*

16.7.3. censure Ottapathu for procuring the transfer of 50% of the shares in the member companies of the Fours Group into his own name as nominee for Choppies.

16.8. On 6 August 2019 the board received a further report – one compiled by EY pertaining to, *inter alia*, the concerns raised by PWC regarding stock irregularities, the bulk sales and the purchase of the four South African stores ("***the EY report***"). EY identified numerous accounting irregularities and suggested, without going so far as to draw a firm conclusion, that the stock liquidation over the Easter weekend

[7] The proceedings have probably become moot in that the new board has re-employed Ottapathu.

appeared to be a sham designed to hide stock losses of over R200 million ("***the sham transactions allegation***").

16.9. On 14 August 2019 the board issued a circular calling an extraordinary general meeting of shareholders ("***the EGM***") to take place on 4 September 2019. The board attached a summary of the DLG and EY reports to that circular and stated that it was in the process of instituting disciplinary proceedings against Ottapathu. The circular also invited Ottapathu to respond in writing to the DLG and EY reports by 27 August 2019 (which response would be announced to the shareholders).

16.10. On 26 August 2019 the board formally charged Ottapathu with specific allegations of misconduct and gave him notice to attend a disciplinary hearing scheduled to take place on 30 and 31 August 2019 ("***the disciplinary charges***"). The charges preferred against Ottapathu related to:

16.10.1. the sham transactions allegation;

16.10.2. two further allegations pertaining to the Fours Group arrangement (allegations which DLG had stopped short of recommending for disciplinary action); *and*

16.10.3. a fourth allegation that Ottapathu had misled shareholders as to the reason for his suspension.

16.11. The next day, 27 August 2019, Ottapathu furnished his response to the circular. In his response Ottapathu challenged the accuracy of both the DLG and EY reports and denied any wrongdoing.

16.12. On 29 August 2019 Ottapathu launched an urgent application in the Botswana Industrial Court to interdict his disciplinary hearing from taking place until after the EGM. In these circumstances, the disciplinary hearing did not proceed.

16.13. At the EGM on 4 September 2019 the shareholders voted to replace the majority of the old board members and a new board was appointed. Significantly, Ottapathu was retained as a director.

16.14. On 11 September 2019 the new board issued a notice to shareholders stating, *inter alia*, the following:

16.14.1. In the board's view there was an urgent need to stabilise the business, preserve value for shareholders, and to ensure that the Company met its obligations.

16.14.2. Following an initial review of the DLG and EY reports (subject to a more detailed review to take place in due course) the board considered that these reports did not disclose any actionable malfeasance. Furthermore, the board felt that continuing to pursue disciplinary action against Ottapathu "*at this time*" would be inimical to interests of the business; Ottapathu was accordingly reinstated as CEO.

16.15. On 24 September 2019 a substantial number of the Company's institutional investors (representing 46% of the issued share capital of the Company) wrote to the chairman of the new board expressing dismay at the fact that Ottapathu had been reinstated, and requested that the board proceed with the disciplinary action against him.

16.16. On 2 October 2019 the chairman of the board wrote to the institutional investors stating, *inter alia*, that:

16.16.1. the board had to prioritise the Company's engagements with its auditors and lenders to preserve shareholders' value;

16.16.2. the board felt that Ottapathu's presence as CEO for the moment was essential to the stabilisation of the business;

16.16.3. the Company would appoint independent senior counsel to undertake a holistic review of the EY and DLG reports (as well as other available evidence) and advise on the need (if any) to proceed with disciplinary action against Ottapathu; *and*

16.16.4. the independent counsel would also consider whether the Company should take action against any other persons, including former directors, in light of the collective responsibility of the old board.

16.17. On 12 October 2019 we were formally briefed to undertake the envisaged "*holistic review*". Our brief is to focus on the aspects pertaining to company law and corporate governance. Messrs Andrew Redding SC and Meyerowitz have been briefed separately to consider the labour law implications, if any, that these facts may have under Botswana labour law.

16.18. On 16 October 2019 the Company issued a statement explaining, *inter alia*, that:

16.18.1. substantial agreement on "*the way forward*" had been reached with the Company's lenders;

16.18.2. following extensive engagement with PwC the 2018 AFSs were expected to be finalised on 6 December 2019;

16.18.3. a sale of the Company's South African business would be concluded as expeditiously as possible; *and*

16.18.4. the holistic review by counsel was expected to be finalised by the end of November 2019.

Documents provided to counsel

17. We have been provided with, *inter alia*, the following material documents:

17.1. Ottapathu's contract of employment dated 1 May 2011;

17.2. the minutes of meetings held by the Company's board of directors ("***the board***") from 2014 to date;

17.3. a "buying agreement" between the Fours Group of Companies and the Company's trading subsidiary CDC dated 28 September 2015 (*"**the Fours Group Buying Agreement**"*);

17.4. several loan agreements between CDC and the members of the Fours Group, as well various guarantees and pledge agreements from the members of the Fours Group and their shareholders in respect of CDC's obligation in terms of the Fours Group Buying Agreement;

17.5. the Desai Law Group report dated 3 June 2019 ("***the DLG report***");

17.6. the report prepared by the advisory firm EY dated 6 August 2019 ("***the EY report***");

17.7. a circular to shareholders dated 14 August 2019 ("***the Circular***") convening the extraordinary general meeting to be held on 4 September 2019 ("***the EGM***");

17.8. the disciplinary charges preferred against Ottapathu dated 26 August 2019;

17.9. a preliminary analysis of the EY report dated 26 August 2019 prepared by chartered accountant Mr Brian Abrahams on the instruction of Ottapathu ("***the Abrahams report***");

17.10. Ottapathu's response to the Circular dated 27 August 2019;

17.11. a comment on the EY report prepared by the advisory firm Grant Thornton[8] dated 29 September 2019; and

17.12. various announcements from the new board elected at the EGM from 11 September 2019 to date.

18. While preparing this opinion we requested our instructing attorney to assist us in understanding the "*Rebate SKU accounting system*"[9] (discussed below) and how same may have been manipulated to assist CDC's[10] executive management in hiding stock losses. Our instructing attorney accordingly arranged a consultation with:

18.1. Mr Tom Pritchard ("***Pritchard***") who is currently the chairman of Choppies' audit committee; *and*

18.2. Mr Sunil Vaduthala ("***Vaduthala***") who is the head of Choppies' data management department.

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8 This firm was engaged to prepare a feasibility study when the acquisition for the South African stores.

9 Grocery SKU in Zimbabwe

10 As we have said, it would appear that all intents and purposes the board of CEL ran the businesses of the trading subsidiary

19. Messrs Pritchard and Vaduthala became involved in the running of Choppies' business only after the appointment of the new board. They conducted their own investigation into the Rebate SKU system and in our consultation they explained to us in layman's terms their understanding of how and why the rebate SKU's were conceptualised and used. What we say in this opinion is predicated upon that understanding as conveyed to us.

Practical approach to opinion and outline of advice

20. We have been requested to peruse extensive, detailed and complicated documentation so as to give our opinion on primarily two reports (the DLG and EY reports) each of which took some 8 months to compile; and to furnish an opinion as a matter of some urgency.

21. We have therefore, of necessity, taken a robust, high-level approach to the facts without delving too deeply into the detail of each impugned transition. We then give our legal opinion on the facts as we understand them.

22. We point out that, particularly with regard to the EY report, a proper legal interpretation of the facts is important. As far as we can tell the EY report simply lists a plethora of accounting irregularities but reaches no firm conclusion as to their consequences (either from a legal perspective or, as far as we can tell, from an accounting perspective). It is therefore important that the EY report, and all the accompanying documents including the DLG report, are viewed holistically and interpreted from a legal perspective.

23. In this opinion we first deal with Ottapathu's powers as CEO and his interaction with the Choppies board. We then consider DLG's finding on the Fours Buying Group

arrangement, before moving on to analyse the EY report and, in particular, the sham transactions allegation. At each stage of the process we comment on the potential failings of corporate governance; and we provide our advice on how the Company should best deal with these failings.

24. We do not comment on possible misconduct committed by any particular Choppies employee under labour law. That issue shall be dealt with by Messrs Redding SC and Meyerowitz in a separate opinion.

25. For the sake of convenience we have prepared a glossary of term and acronyms annexed hereto marked "**A**". In line with our robust approach all figures have been rounded off to the nearest million.

Corporate governance issues in general

26. A potential failure of corporate governance was first explicitly recognised by the Choppies board at a meeting held on 25 September 2018. Prior to this date comments in the minutes were limited to the need for timeous receipt of information from management; the need for an investment committee; and indeed the need for more accurate minute taking at board meetings.

27. These failures of corporate governance appear to be recognised by the key role players. In the meeting of 25 September 2018 the board decided (for the first time) to restrict Ottapathu's powers to transact on the Company's behalf; and proposed certain corporate governance reforms. Ottapathu himself proposed a corporate governance overhaul immediately prior to his suspension as CEO in May 2019.

28. In our analysis below we shall first discuss the various issues raised in the DLG and EY reports; and then move on to discuss further potential failings of corporate

governance relating to Choppies' intra-group relationships and Ottapathu's remuneration.

Ottapathu's powers as CEO

29. Ottapathu's contract of employment, dated 1 May 2011, was concluded with Choppies Enterprises (Pty) Ltd ("***CE***") prior to the listing of this company on the Botswana and Johannesburg Stock Exchanges (although the contract is on a letterhead of CDC). The contract provides Ottapathu with virtually unlimited powers to run the Company (including the ability to conclude contracts and acquire assets without the need for board approval regardless of the quanta involved[11]).

30. His powers are, nonetheless, curtailed by the caveat that he must always act in the Company's best interests (a provision that echoes his statutory and fiduciary duties to the Company *qua* director). The powers given to Ottapathu in this contract can be paraphrased to mean that, from an operational perspective, he essentially "was the company".

31. We are instructed that Ottapathu was the CEO of CE for a number years before it was listed on the Botswana Stock Exchange ("***BSE***") in January 2012. It is therefore quite surprising that the contract of employment was concluded less than a year before the listing and not revisited thereafter. It could be considered a failure of corporate governance for the board of the newly listed entity to not revisit the CEO's contract of employment[12] (particularly in light of the wide powers conferred therein). In a private company it might have been less inappropriate for Ottapathu to have had

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11 The exercise of such powers, potentially, might have resulted in a breach of the provisions of section 128 of the Act – for present purposes we should simply point this out to demonstrate that, certainly upon listing, the employment contract ought to have been revisited.

12 And indeed all contracts of employment

full control over the *de facto* running of the business but, in a public company, this would not be the case.

32. The first principle of King IV[13] is that the board of directors should govern effectively. This cannot be done when all operational power is effectively given to one person to the exclusion of the board. Under such a scenario that person could materially alter the company's position between board meetings and the board would effectively be powerless to do anything about it.

33. On 25 September 2018 the board declared that Ottapathu should no longer have the authority to incur capital investment on behalf of the Company; and that all such future transactions must first be vetted by an investment committee. The board also decided that Ottapathu should be prohibited from entering into any new contracts without the explicit approval of the board.

34. This action by the board was commendable but, not to put too fine a point on it, all a little too late. The major transactions culminating in PwC's refusal to sign off on the 2018 AFS had already taken place.

35. As we have said PwC had two main concerns. The first was certain accounting, risk and legal compliance issues arising from CDC's financing of the Fours Buying Group to the tune of BWP100 million; and the second was the acquisition of four South African stores from ANE/Devland for a substantially identical sum (approximately R130 million) as that purportedly raised by CDC as a result of a rapid liquidation of bulk stock to Devland and an undisclosed number of traders (identified only as Somali

13 Part X of the Act, too, enshrines this principle

traders). In both cases Ottapathu was the driving force behind the relevant transactions.

36. If these complex high value transactions had required prior board approval (thereby making them subject to the collective scrutiny of the independent non-executive directors):

36.1. it is not improbable that the board would not have approved of one or other or either of them without full and proper scrutiny; and

36.2. in the event of the board approving either or both of the transactions, this would have happened only after proper consideration and deliberation and the queries now raised by PwC might not have been raised at all.

37. It would appear from the documents we have seen that Ottapathu asserts that the board was aware of these transactions. The board members, however, complain that they were kept in the dark.

38. It seems to us, from a perusal of the minutes, that only the most general references to the buying group arrangements and to expansion into South Africa are made. The minutes certainly do not reflect that the board discussed these transactions in any detail; nor would it seem that the board was made aware of the financial and legal risks associated therewith.

39. It is, nevertheless, clear that the board was aware of the buying group arrangement and of the Company's expansion in South Africa. The board therefore knew that various high value transactions were taking place but chose not to interrogate their underlying rationale or the assignation of value associated therewith further. Instead, they chose to allow Ottapathu free rein.

40. The above highlights the natural tension between a chief executive's duty to keep his/her board fully informed about all proposed material transactions, and the board's duty to consider properly the import of the transactions before approving them.[14]

41. It is therefore difficult to lay the blame for the fact that the 2018 AFS have been delayed squarely on one party. On the one hand Ottapathu should have kept the board fully informed of the detail of these transactions (and, for the most, he claims that he did just that – regardless of the contents of the minutes). On the other hand, the board allowed Ottapathu effectively to run the company with substantially complete freedom for several years creating a situation where the board, seemingly, invariably deferred to him, taking him at his word, and not interrogating the detail of the transactions to which he committed the Company.

42. There can be no doubt that the permissive environment in which Ottapathu was allowed to run the company as director and CEO constituted a failure of good corporate governance. Although it is understandable that neither the shareholders nor the board wanted to unduly shackle a CEO who had served the Company well prior to its listing, upon such listing, the board was obliged to ensure that the Company was run properly and effectively, and that the actions of its CEO were subject to proper and stringent scrutiny.

43. The lack of effective leadership on the part of the board, we suggest, could have been avoided if the steps taken by the board in September 2018 board had been put in place considerably earlier.

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[14] We refer again in this context to Part X of the Act and the duties imposed upon a board particularly in terms of the provisions of, *inter alia*, sections 130 and 158.

44. In the event, as we have pointed out, during a consultation held on 14 November 2019 the Company's current audit committee chairperson (Mr Tom Pritchard) informed us that a new "Approvals Framework Policy" has now been introduced. This policy requires investment committee and Board approval for all major transactions, borrowings and capital expenditure.

45. Accordingly, the circumstances that gave rise to the failures of good corporate governance appear now to have been largely addressed.

46. We would, however, also recommend that Ottapathu's contract of employment be revisited to ensure that his authority to act on the Company's behalf is limited to that contained in the above "Approvals Framework Policy".

47. We turn now to the DLG report and the EY report.

The DLG report

The Fours Buying Group arrangement

48. As appears from the DLG report the buying group arrangement commenced in April 2014. This arrangement was one between CDC, Payless and a company Woodblock (Pty) Ltd t/a Fours Cash and Carry ("***Woodblock***") and was regulated by the terms of a written agreement ("***the 2014 buying agreement***"). The Company's legal advisers at the time, SK Attorneys, were of the view that the arrangement, *prima facie*, was in contravention of the Botswana Competition Act of 2009 Cap. 46:09[15] and applied to the Competition Authority ("***the CA***") for an exemption. The CA rejected the application and, following an appeal to the Competition Commission, on

[15] This Act has been repealed and replaced by the Competition Act of 2018

10 July 2015 the matter was settled on the basis that the buying arrangement would be permitted to remain in place until 30 November 2017.

49. On 28 September 2015 CDC entered into a new buying arrangement with:

49.1. Payless;

49.2. Sharpview (Pty) Ltd t/a Fours Cash and Carry, Gaborone ("***Sharpview***"); *and*

49.3. Custody Investments (Pty) Ltd t/a Fours Cash and Carry, Maun ("***Custody***").

50. In terms of this buying agreement (hereafter "***the 2015 buying agreement***") Payless, Sharpview and Custody would be known as the "Fours Group of Companies".

51. The buying agreement was accompanied by several loan agreements between CDC and the members of the Fours Group, as well various guarantees and pledge of shares agreements from the members of the Fours Group and their shareholders to secure CDC's obligations to suppliers in terms of the buying agreement.

52. The buying agreement also made provision for additional companies to join the buying group at a later stage on condition that they sign identical loan agreements and guarantees and execute similar pledges.

53. Finally, the buying agreement was also accompanied by two acknowledgments of debt ("***AODs***") reflecting that Payless owed Woodblock BWP 36.8 million; and that Woodblock owed CDC the same amount. As appears from the DLG report, Woodblock was, at the time, a buying entity for Payless. It became dormant shortly after the conclusion of the 2015 buying agreement. By virtue of the Fours Group's relationship with CDC; Woodblock fell out of the picture and its debt to CDC was assumed by Payless.

54. Thus the new buying agreement was concluded a mere two months after the settlement with the CA. Whilst the basis upon which the Company believed that it was entitled to do this is not clear, it would appear that the parties believed that the exemption granted by the CA until 30 November 2017 would cover this new agreement.

55. In such circumstances, and in anticipation of the fact that the exemption previously granted was to lapse on 30 November 2017, on 25 April 2017 CDC applied for an extension of CA's approval of yet a further buying agreement concluded on 22 April 2017 ("***the 2017 buying agreement***").

56. The CA rejected this application and ruled that the parties should terminate the buying arrangement by no later than 10 January 2019. On 22 February 2019 the parties provided the CA with a joint written undertaking that the buying arrangement had indeed been terminated ("***the joint undertaking***").

57. CDC did not bring the 2015 buying group agreement to the CA's attention – it would seem that it did not regard this as necessary – (in circumstances where it did bring the 2014 and 2017 agreements to the CA's attention). DLG concludes that this agreement was not in contravention Botswana competition law (primarily because it was incumbent upon the CA to investigate the arrangement if it believed that it was appropriate to do so and there was no obligation on the parties to notify the CA thereof). We believe this conclusion to be sound.

58. The only *caveat* raised by DLG is an allegation that the buying group in fact appears not to have been terminated contrary to the joint undertaking. This allegation (made, it would seem, by the attorneys for Payless' principal shareholder and sole director,

Mr Mohamed Malique ("***Malique***") during a consultation with DLG), is that CDC continues to run Payless to the operational exclusion of Malique.

59. If this is true then it constitutes a wilful contravention of the CA's ruling and perhaps even a fraudulent misrepresentation. It would also obviously constitute a failure of the governance principles of transparency and compliance. Having said that, we have not seen any documents substantiating this allegation (and we note that it contradicts what Malique told DLG in an interview held on 19 November 2018).

60. The current board will, obviously have investigated the matter and will have satisfied itself that the buying agreement has indeed been terminated. In the circumstances it is not necessary for us to deal further with this allegation save only to point out that it would appear to be contradicted by an action brought for the return of Fours Group shares transferred to Ottapathu.[16] In this action it is alleged that the buying group arrangement has been terminated and that the raison d'être for its existence has fallen away.

61. The above notwithstanding, the DLG report finds no fault with the agreements that underpin the buying group arrangement (apart from their possible effect on the marketplace under competition law – an aspect which can only be assessed by the CA on a case by case basis). We are in agreement with DLG that the agreements themselves are "*inherently valid, suitable and fit for purpose*" and that no corporate governance issues arise.

16 We deal with this more fully later

Dubious transactions under the Fours Group Arrangement

Introduction

62. Whilst concluding that the buying agreements are valid, DLG identifies other matters during the time that the buying group was in existence that might indicate failings of corporate governance, breaches of company law, and perhaps further direct breaches of competition law. We have identified three material issues worth considering in this opinion; and we deal with them in turn below.

Failure to perfect pledges and the augmentation of the Fours Group

63. In terms of the 2015 buying agreement, the shareholders in the Fours companies pledged to CDC their shares in their respective companies as security for CDC's obligations to suppliers in terms of the buying arrangement. However, as of June 2019 the pledgors had not delivered the share certificates to CDC (rendering the security unperfected but still enforceable).

64. Furthermore, between 2015 and 2018 as many as 7 new companies joined the buying group (the shares in these companies were all, apparently, held by the principal Fours shareholders.) The applicable guarantees and pledges of shares in CDC's favour, as provided in the buying agreement were not enforced by CDC and were not executed.

65. We are not aware whether this lack of compliance was an oversight or whether CDC was of the view that it already had sufficient security from the personal guarantees of the principal Fours shareholders (which guarantees would have extended to their ownership of these additional companies). We also do not know what value (if any) these shares might have had.

66. However, good corporate governance requires the proper governance of risk. It would appear to us that these security arrangements were in place to manage risk; and therefore CDC[17] should have insisted upon adherence with their terms. We might add that we have seen nothing in the minutes provided to us indicating that this was ever considered.

67. This failure of proper corporate governance appears to have become academic inasmuch as it would appear that the buying agreement has been terminated and the shares that were delivered in pledge must be returned.

The transfer of Fours Group shares into Ottapathu's name

68. In August 2016 Ottapathu procured the transfer of 50% of the shares in each of the Fours Group companies then participating in the buying agreement into his own name. Ottapathu asserts that he did this as nominee for CDC as "additional security", and for the purpose of CDC benefitting from a possible upliftment in the event of a listing or private equity investment into Fours.

69. Ottapathu explained further that at the time there were rumours that Fours would not be able to pay its debts. The shares were therefore transferred to him "*in a panic*" after being advised by CEL's company secretary Mr John Little ("***Little***") that the shares had to be "*in someone's name*". Little denies this and states that the instruction came directly from Ottapathu.[18]

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17 We, like DLG and EY, do not distinguish, for these purposes, between CEL and CDC. It would seem that the companies did not distinguish and, as we have said, that the board of CEL ran the affairs of CDC

18 Either way this does not altogether make sense: if Ottapathu's concern about the financial stability of the Fours Group was well-founded, the shares would have been of little value and Ottapathu would almost certainly have looked for a way in which to extricate CDC from the buying group arrangement. There could have been no "upliftment" to benefit from.

70. It has throughout been asserted by the Fours Group that the transfers to Ottapathu were given as security for the Fours Group's debt to CDC and that the shares were held on its behalf. Indeed, as we have pointed out, the Fours Group has sued Ottapathu and CDC for the return of the shares on precisely that basis.

71. From the disciplinary charges prepared by attorneys Norton Rose Fulbright[19], it would appear that the previous board took the view that Ottapathu had acquired beneficial ownership in the shares and had accordingly misappropriated a corporate opportunity[20] and made a secret profit at the Company's expense. We are satisfied that neither proposition is correct because:

71.1. during the course of his ownership of the shares Ottapathu received no financial gain;

71.2. Ottapathu has now signed a declaration of trust indicating that the shares were acquired by him as nominee for CDC; *and*

71.3. Fours Group has asserted throughout that the shares were transferred as security and that beneficial ownership in them was never given. As we have pointed out it has sued for their return.

72. Furthermore, the company secretary was aware of and facilitated the transfer of shares; and the transaction is a matter of company record. Even the most cursory examination by the board would have revealed the transaction. If Ottapathu had beneficial ownership of the Fours Group shares he could hardly expect that he could conceal this shareholding from CEL's board indefinitely.

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19 We understand that Norton Rose Fulbright assisted the old board in preparing the disciplinary charges against Ottapathu.

20 As articulated in the well-known case of *Robinson v Randfontein Estates Gold Mining* Co Ltd 1921 AD 168 and any number of cases following it

73. Thus it seems inherently unlikely that it was Ottapathu's intention to acquire the shares and to make a secret profit at the Company's expense given the circumstances surrounding the Company's relationship with Payless / Fours Group.

74. It is also unlikely that the Fours Group companies would have transferred beneficial ownership in 50% of their shares for no consideration at all. This, too, provides an indication that the shares were transferred to secure the debts of the Fours Group companies to CDC.

75. Of course, the fact that it is unlikely does not have as a consequence that the manner in which the transactions took place was compatible with good corporate governance. As we have stated, it is our view that Ottapathu's intention in taking transfer of the Fours Group shares was to obtain maximum benefit from Choppies' relationship with that Group and that he acted in what he perceived to be the best interests of the company. However, good corporate governance also requires a culture of transparency and compliance; in our view, Ottapathu did not comply with these requirements. We point out:

75.1. First, Ottapathu should have explicitly informed the board that he had procured the transfer of the shares into his own name as nominee for Choppies and ensured that a board resolution recording this was passed (no such recordal is contained in the board minutes).

75.2. Second, he should have signed a nominee form or declaration of trust (as he has now done) at the time he acquired the shares. Had he done so, there could have been no suggestion that he took transfer of the shares for his own benefit.

76. The DLG report posits that, as things currently stand, the transactions underlying the share transfers are probably void *ab initio*. If this is so, the possible contraventions of the BSE listing requirements regarding related party transactions, as well as the competition and tax law issues ("***the compliance issues***") referred to in that report, are probably moot. We do not take issue with this view.

77. In any event, it would appear that no valid defence to the action for the retransfer of the shares could be mounted and that the shares must be transferred back. This, too, would result in the compliance issues being moot.

78. There is a further factor: As we have stated, we believe that it must be accepted that the shares are held as nominee for Choppies as security for CDC's obligations to suppliers under the Fours Group buying arrangement. However, it would appear that Ottapathu sought to circumvent the potential compliance issues by procuring the transfer of the shares to himself rather than to Choppies. Indeed, the DLG report reflects that he said that he wanted to keep the acquisition "off the books". He thus recognised that there might have been compliance implications in the event that the shares were transferred to Choppies

79. It is beyond the scope of this opinion deal with compliance issues. However, we must point out that Ottapathu's avowed intention (keeping the transaction "off the books") was improper. This is a matter that should have been debated properly in a board meeting. In addition legal advice ought to have been obtained.

80. We are also concerned about the appropriateness of not recording the share transfers (and indeed the entire Fours Group arrangement) in the Company's records. If the shares were indeed held as nominee for Choppies then this should have been dealt

with in a note in the AFS giving details of security for the indebtedness of the Fours Group .

81. Seeking to ensure that the share transaction was "kept off the books" constitutes yet a further failure of good corporate governance on Ottapathu's part albeit, that he appears to have acted in what he believed to be in the best interests of Choppies.

Financial assistance to Malique

82. In March 2013 a Mr Willem Henning ("***Henning***") agreed to sell 90% of his shares in Payless to Malique. As consideration for this sale, Malique would pay Henning an annual amount equal to a percentage of Payless' annual turnover for a period of 10 years (subject to certain minimum payments, regardless of the actual turnover achieved, aggregating BWP11.25 million).

83. Between March 2013 and February 2018 CDC assisted Malique in paying the purchase consideration by paying a total of BWP4.3 million directly to Henning on Malique's behalf.

84. As is pointed out in the DLG report, the nature of this financial assistance and the terms upon which Malique is required to repay the debt to CDC is not documented in writing. Furthermore, DLG states that it cannot ascertain any commercial reason for assisting Malique in this respect.

85. In Ottapathu's response to the DLG report he did not seek to justify these payments on any commercial basis. He merely stated that the assistance to Malique formed part of the debt owed by Payless/Fours to CDC. Accordingly it would appear that Ottapathu considered the transaction as an extension of the credit facility granted to

Payless/Group which he believed to be to the Company's ultimate commercial benefit.

86. In terms of his contract of employment Ottapathu acted within his powers in deciding to assist Malique in purchasing Henning's shares. This notwithstanding, there was no disclosure of this assistance to the board in circumstances where there should have been; and there is no recordal of the arrangement in writing. This failure of transparency and compliance demonstrates again just how inadequately the board was involved in the running of the affairs of the Company.

87. Interestingly, in the Circular disseminated by the old board summarising the DLG report it is stated that Malique's attorney informed DLG that Malique was not the beneficial owner of the Payless shares but that Choppies was in fact the beneficial owner.

88. In the disciplinary charges that Ottapathu was called upon to answer it is alleged that Malique confirmed that he was simply Ottapathu's nominee and that he took transfer of Henning's the shares as nominee for Ottapathu in his personal capacity.

89. These two additional (and inconsistent) allegations are not supported by any documents that we have seen. In addition, there is no suggestion in the DLG report that Malique acquired the Payless shares as nominee for Choppies or Ottapathu.

90. However if the Henning shares were acquired as nominee for Choppies, this would trigger related party, competition and/or tax implications; furthermore if the shares were acquired as nominee for Ottapathu he would have been guilty of a misappropriation of a corporate opportunity.

91. Ultimately, as we have said, we have seen no substantiating evidence other than the rather bald allegations made in the Circular and the Charge Sheet and, whilst we cannot be definitive on this matter, it seems to us unlikely that either proposition will be established.

92. Once again, however, the financial assistance to Malique without proper board involvement and in the absence of a properly documented recordal of the transaction constitutes a failure of transparency and a failure of good corporate governance; but nothing more.

Board knowledge of the Fours Buying Group arrangements

93. The board minutes in our possession reveal that the board had some knowledge of Payless and the Fours Buying Group. However, the references in the minutes are sporadic, only in general terms, and often constitute vast oversimplifications of what precisely occurred.

94. The minutes refer to Payless and the Fours Group interchangeably. The competition law issues are referenced sporadically but the precise nature of the buying arrangement is never fully revealed in the minutes. For example, Ottapathu reports to the board that "*we have 80% of the shares in [Payless] as security*" and "*we are currently controlling the finances of the business and are expecting full operational authority soon*".[21] The minutes of 15 June 2017 state as follows:

> *"6. …2017 /32.2 Fours Cash & Carry is showing positive signs of improvement and has begun to achieve profitability. There are no immediate plans to purchase this business as its wholesale business model conflicts with that of Choppies."*

[21] Minute, board meeting held on 18 March 2015

95. DLG states in its report that on a casual reading of the minutes, it would appear that Payless and/or the Fours Group are the subject of an equity investment by Choppies. This impression is indeed created and is a matter of concern – the cost benefits achieved by a buying group are of a substantially different nature from a competition perspective than an equity investment.

96. In light of the above, it appears that there was insufficient oversight by the board regarding nature and the administration of Choppies' relationship with the Fours Buying Group. It is not clear whether this was a result of poor reporting by Ottapathu, poor minute taking, or a lack of oversight on the part of board. Whilst it was likely a combination it would seem that this is yet a further illustration of the fact that Ottapathu was allowed free rein to run CDC as he saw fit.

97. As we have pointed out above, this could not have happened had the board put in place limits on Ottapathu's authority to make investments and undertake high value transactions unsupervised. The board's failure to do so constituted yet a further failure of the requirements of good corporate governance.

Conclusions on the Fours Buying Group issue

98. The commercial efficacy of the Fours Group buying arrangement is not in issue for present purposes. What is clear is that there was a failure of good corporate governance pertaining to transparency, risk, compliance and effective leadership.

99. In short, Ottapathu failed to disclose adequately the nature of this arrangement to the board. Instead he was allowed, unsupervised, to go ahead with the conclusion of the buying agreements referred to earlier and to implement them as he saw fit. It is

self-evident that this should not have happened and Ottapathu should have involved the board in all aspects of the transaction.

100. On the other hand, the board, which knew, in general terms of the buying arrangement, should have involved itself more actively in the conclusion of the agreements and the implementation of the arrangement; as well as the concomitant legal and financial risks associated therewith. Once again the board gave Ottapathu far too much autonomy.

101. Instead of involving itself actively and overseeing the project the board, quite clearly, sat supine and permitted Ottapathu to go ahead unsupervised. This is inappropriate for a transaction as significant as this involving as it did the potential exposure of the Company to expenditure totalling many millions of Pula.

102. The above notwithstanding, in our view, these failings save in one possible respect do not appear to have had any detrimental consequences for the Company in the running of its Botswana operations. It is clear from what we were told by Mr Pritchard that the previous shortcomings that have been identified have been addressed. Save in the possible respects referred to below, we do not believe that any good purpose would be served, in these circumstances, to take any form of action against the former directors.

103. The only *caveats* to our conclusion that no action should be taken against any of the directors are the allegations that Ottapathu:

103.1. took transfer of the Fours Group shares for his own personal benefit;

103.2. used Choppies' money to finance Malique's purchase of the Payless shares in circumstances where Malique was simply holding the shares for Ottapathu's benefit; *and*

103.3. breached the undertaking given to the CA that the Buying Group has been terminated/disentangled.

104. As discussed above, on the evidence before us it is unlikely that Ottapathu acquired beneficial ownership of the Fours Group shares by procuring the transfer into his own name. We say with confidence that we do not believe that this could ever be established.

105. There is also no credible evidence that we have seen indicating that Malique acquired the Payless shares from Henning as nominee for Ottapathu. (As we have said this assertion is made in the charge sheet. We have seen no evidence to substantiate it and it is not mentioned in the DLG report). One again it seems to us that it is unlikely that this allegation will ever be established.

106. It is stated in the DLG report that, during more recent negotiations Malique's attorney Mr Dutch Leburu informed DLG that CDC still has operational control over Payless (and accordingly that the Fours Buying Group has *de facto* not been terminated/disentangled). The new board has presumably investigated this assertion and will have determined whether it is correct. If it is, then, of course, Ottapathu deliberately misled the CA by stating that the buying arrangement has been terminated/disentangled.

107. Having said that, we must point out that this allegation contradicts what Malique and Leburu told DLG in an interview held on 19 November 2018. At this stage the

allegation remains unsubstantiated. It is, however, a matter of fact readily ascertainable by the new board.

108. In summary, on the evidence before us we see no *prima face* evidence that Ottapathu is guilty of any actionable malfeasance in relation to the Fours Buying Group. However, if new evidence comes to light a re-evaluation of this assessment may be warranted.

The EY Report

109. The EY report is concerned with activities in South Africa and Zimbabwe. After exhaustive evidence gathering over the course of 8 months the report lists a slew of identified irregularities. However, EY does not draw any conclusions about the distinct or composite meaning of these irregularities. It is therefore left to the reader to interpret their legal significance.

110. In broad terms the report focusses on four aspects. The first is the sale of bulk stock by the Company in both South Africa and Zimbabwe over March / April 2018 (referred to as "***the Easter trading period***"). This is closely linked to the second aspect: CDC's purchase of four stores in South Africa from ANE / Devland.

111. The third and fourth aspects pertain to money laundering allegations in Zimbabwe and related party issues in various jurisdictions, respectively. For the reasons that follow we shall spend the bulk of our analysis on the first two issues (which we shall refer to as "***the Easter transactions***").

The Easter transactions

Introduction

112. Although EY does not reach explicit conclusions, it does suggest that Choppies management might have attempted to hide stock losses of nearly R200 million by manipulating the company records and then entering into simulated financial transactions as part and parcel of the fraud to hide those losses. The gist of this suggestion is that by artificially inflating the price of South African store purchases, and then using non-existent stock ostensibly to pay the inflated purchase prices for those stores, the Easter transactions had the effect of making stock losses disappear from the Company's records.

113. In order to understand fully what might have taken place, we must first set out the relevant facts; and then articulate how the use of a stock-keeping system of "*Rebate SKUs*[22]" could have enabled management to conceal stock losses. For the sake of simplicity we shall first only deal with the Easter Transactions as they pertain to Choppies' South African operations.

The facts

114. On 29 November 2017 Ottapathu informed the board that "*the 2017 Audit [ending 30 June 2017] did not go as planned and… the Company lost sales due to closure of stores for stock counting audits in South Africa*". He also explained his dissatisfaction with auditors KPMG, and generally blamed them for the audit problems and the loss of opportunity to sell stock.

115. In early January 2018 KPMG was replaced by PwC as the Company's auditors.

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22 Grocery SKUs in Zimbabwe

116. On 20 March 2018 the Company's audit committee reported to its board that there was "*an apparent significant shortfall in stock*". In an attempt to assess the extent of the problem (in light of the upcoming financial year-end in June 2018) the board resolved, *inter alia*, to carry out stock counts in three stores in South Africa. A considered decision was taken to execute the stock counts after the busy Easter period. Accordingly the stock counts were scheduled to commence on 7 April 2018.

117. Prior to the stock counts, and over a period of four days (24 to 27 March 2018), sales to the value of R130 million ostensibly took place. Specifically, positive value adjustments[23] were made to 20,000 stock keeping units ("***SKUs***"), across 53 South African stores, to the value of R130 million.

118. The vast bulk of these SKUs (totalling R129 million) were then sold over the 2018 Easter trading period as follows:

118.1. between 24 March and 8 April (a period of 15 days) SKUs to the value of R84 million were sold to certain "*wholesale customers*" from the 53 South African stores; *and*

118.2. between 6 and 9 April (a period of 4 days)) SKUs to the value of R45 million were sold to Devland from the 53 South African stores.

119. EY was informed by Choppies' South African chief buyer, Mr Zaheer Paruk ("***Paruk***") that these "*wholesale customers*" were Somali informal traders; and the arrangement was that they would fetch the stock from the individual Choppies stores and pay cash to Devland which, in turn, would remit the money to CDC (although the EY report

[23] By transfer from Rebate SKUs to store SKUs (discussed in paragraphs 130 *et seq* below)

reflects that the payments were in fact made by ANE Western Cape (Pty) Ltd ("***ANE***") a company connected to Devland).

120. Between 9 and 11 April 2018 PwC conducted a stock count at three South African stores and no significant discrepancies could be found.

121. Between 13 and 17 April (a period of 11 days) further SKUs to the value of R27 million were sold to Devland from the Choppies distribution centre. However, EY identified that as at 30 December 2018 CDC had not received payment from Devland for these sales (referred to as "***the Distribution Centre Credit Transaction***").

122. There was also a return of stock ostensibly to the value of R11 million as against an underlying sale of only R200 000.00 (referred to hereafter as "***the Stock Return***").

123. During the board meeting of 24 April 2018 the then Audit Committee chair, Mr Robert Mathews ("***Mathews***") complained that management should have allowed the audit team first to verify the existence of the stock before the bulk sales took place. However, Mathews acknowledged that most of the cash for the sales had been received, and that the stock counts undertaken after the stock liquidation revealed no significant discrepancies. The board nevertheless resolved that the purchasers should be asked to provide written confirmation that the specified stock was actually received.

124. EY then considers the aggregate amount received for the bulk sales in comparison with the purchase price paid by Choppies for four South African stores from ANE (including one referred to as Zandspruit[24]. For convenience we shall refer to these four stores as "***the Zandspruit stores***").

[24] The other three are referred to as Cliffy's, Hebron and Bela-Bela.

125. In late 2017 Choppies expressed an interest in purchasing the Zandspruit stores from ANE for what appears to have been an agreed aggregate purchase price of R55 million. However, by June 2018 the purchase consideration had increased to R146 million and the purchase went ahead at this price.

126. In June 2018 the advisory firm Grant Thornton ("***GT***") issued a "*feasibility report*" on the value of these stores placing an aggregate value of R146 million on them. EY appears to conclude that the GT report was commissioned for the purpose of calculating the purchase price for the stores. GT has issued a rebuttal stating that its report was a value allocation exercise conducted after the sale (for the purposes of allocating goodwill in Choppies' books of account). Regardless of the purpose of the GT report; same was only finalised in June 2018 and then subsequently backdated to January 2018 (apparently at the request of Ottapathu).

127. Sale agreements for the purchase of the Zandspruit stores, reflecting a purchase consideration of R146 million, were also concluded in June 2018. For reasons that are not satisfactorily explained, these agreements were also backdated to January 2018.

<u>Understanding the Easter transactions</u>

Introduction

128. As discussed above, EY, in its report does not reach any positive conclusions (whether from a legal perspective or, as far as we can tell, from an accounting perspective). It simply lists a slew of accounting irregularities and demonstrates, persuasively, (without actually reaching this conclusion) that these irregularities could have been used to hide significant stock losses.

129. In our view the EY report demonstrates that the Easter transactions were either legitimate or that they were contrived to hide stock losses. To understand this we must consider management's use of the "*Rebate SKU system*".

Understanding the Rebate SKU system

130. In 2017 Choppies' executive management created a stock keeping entry known as a "*Rebate SKU*" for the purpose, so we were told by Mr Pritchard and Mr Vaduthala, of managing re-order quantities ("***ROQs***"). This was put in place as a management tool to ensure that when stock was ordered, a provision could be made to better manage slow moving and excess and obsolete stock. By way of example:

130.1. A store would order 100 units of stock (for example, Joe's peanuts). However, the store also knew from historical analysis that 20 of the 100 units might not sell within the expected timeframe. To mitigate against this risk, management made separate provision in the stock records for slow-moving or excess stock and called it a "*rebate*" SKU for Joe's peanuts (as opposed to a normal SKU Joe's peanuts). 20 units of Joe's peanuts would be transferred to this SKU.

130.2. The objective was that, if any particular store required a supply of Joe's peanuts, that store could identify other stores that had these in stock that had been transferred to rebate SKUs. These could be delivered to the store requiring them without having to purchase additional stocks from a supplier. Thus the rebate SKU was created to mitigate against holding excessive quantities of slow-moving stock (which could become valueless through expiry or obsolescence) by redistributing that slow-moving stock to stores requiring the items concerned.

131. To illustrate further in regard to any particular store: where 100 units of Joe's peanuts were ordered from a supplier and were delivered:

131.1. 100 units would be taken into stock;

131.2. management would allocate 80 units to "*Joe's peanuts SKU*"; *and*

131.3. management would allocate 20 units to "*Joe's peanuts Rebate SKU*".

132. The units reflected in the Rebate SKU could then be made available to any Choppies store.

133. Internally, when sales of Joe's peanuts took place the stock reflected as "*Joe's peanuts SKU*" would be adjusted to take account of these sales. However, if, say, 85 units were sold then the underlying SKU would reflect a negative balance of 5 units of Joe's peanuts. In order to clear the negative balances management would transfer 5 units of Joe's peanuts from the rebate SKU's back to the underlying store SKU.

134. To continue the example above, if 100 units are actually in stock at a particular store, and 20 have been transferred to Rebate SKUs, then a stock count would reveal an excess of 20 units of stock over what is reflected in the underlying store SKUs. Furthermore, if, say, 20 units had been stolen this would not be identified until a transfer from the Rebate SKUs was requested (or, at the very least, until the Rebate SKU is taken into account when assessing the stock count).

135. Thus, in order to maintain accurate stock records, the underlying Store SKU's and the Rebate SKU's should have been reconciled regularly.

136. This system of SKUs, as the EY report demonstrates, could have been misused to hide stock losses.

137. To sum up: the system of Rebate SKUs was a useful tool that could and should have been used to optimise stock usage across the various Choppies stores. It is the possible manipulation of the Rebate SKU system (we demonstrate this later) that EY identified in its report that could have been used fraudulently to disguise stock losses.

How the Rebate SKUs could have been manipulated fraudulently

138. That the Rebate SKU could have been misused is amply demonstrated in the EY report. Simply put, stock losses in an identified amount that had been verified physically could be hidden by:

138.1. Transferring stock to that identified amount from Rebate SKUs to underlying SKUs even though the stock reflected in the rebate SKUs did not in fact exist.

138.2. This fictitious stock could then be "sold" to someone who would necessarily have to be party to the fraud.

138.3. The purchaser would pay for the fictitious stock and contemporaneously the purchase price would be repaid. Of course a reason for this repayment would have to be contrived.

138.4. Thus, instead of being obliged to write off stock in the identified amount, the records of the company would reflect that stock to that amount had been sold.

139. We demonstrate this by reference to EY's analysis revealing a possible manipulation of the Rebate SKUs at Choppies' Boitekong store:

139.1. In October 2017 it would appear that a stock count in that branch revealed stock losses of R4 million. On 2 November 2017 R4 million worth of stock was

transferred to the Boitekong Rebate SKUs (with the corresponding store SKUs being reduced by R4 million thus making the losses go away).

139.2. A further stock count on 16 January 2018 revealed a further stock loss of R2 million, and on 30 January 2018 a further R2 million was transferred to the Boitekong Rebate SKUs.

140. On 24 March 2018 all Boitekong Rebate SKUs were transferred back to the Boitekong Store SKU and then sold to Devland on 6 April 2018. This action appears, *prima facie*, to constitute the fictitious sale of non-existent stock (discussed in more detail below).

141. Thus stock losses of R6 million could have been converted into R6 million worth of fictitious sales to Devland. This, of course, pre-supposes that actual stock was not delivered to Devland.

<u>A possible connection between the Rebate SKU system and the Devland purchases</u>

142. Between November 2017 and February 2018 Choppies transferred R130 million worth of stock from store SKUs to Rebate SKUs.

143. Between 24 and 27 March 2018 Choppies then re-transferred R130 million worth of stock from the Rebate SKUs to underlying SKUs.

144. Choppies then sold the stock represented by the underlying SKUs to Devland and the Somali wholesalers the sum of R129 million; ANE paid Choppies R129 million for the stock ostensibly, on behalf of both Devland and the Somali wholesalers who allegedly paid cash to ANE for on-payment to Choppies.

145. Choppies more or less contemporaneously purchased four South African stores from ANE for R145 million (it would appear to us that Devland and ANE have interests that are aligned, if not substantially identical).

146. Thus at more or less the same time, Devland / ANE made payment to Choppies of an amount of R129 million and Choppies purchased and paid for four stores in an amount of R145 million.

147. As we have pointed out, it would appear that a purchase price of R55 million for these same stores was agreed in 2017. The tenor of the EY report suggests that if this was indeed the true purchase price, then the additional amount paid by Choppies could be fictitious and the payment could have been contrived to hide stock losses by the manipulation of the Rebate SKU system.

148. If this is indeed what happened, then instead of being obliged to write-off stock to the value of R130 million, the Choppies AFS would reflect the acquisition of four stores for a purchase consideration of R145 million (with a corresponding increase in fixed assets and goodwill) in its books in circumstances where the true value of the stores was not more than R55 million.

149. We cannot say what the true position is. What we can say is that the Easter transactions could have been used in the manner described above to hide stock losses. We can also say that the EY report demonstrates that there is a considerable amount of circumstantial evidence to suggest that this could have occurred.

150. Of course, Devland/ANE would, necessarily, have had to participate in the fraud outlined above.

Circumstantial evidence and the need for further investigation

151. Although we cannot say with any certainty that the Easter transactions were in fact fraudulent, there is a considerable amount of circumstantial evidence which suggests that this was the case. The following are illustrative:

151.1. The Rebate SKU system could have been misused in the manner described above and detailed in the EY report.

151.2. The Rebate SKU system was introduced in 2017 and then discontinued after April 2018. These dates correspond precisely with the period that Choppies appears to have experienced stock loss issues.

151.3. Mr Tom Pritchard informed us in consultation that no excess stock was transferred between stores for the stated purpose of managing re-order quantities efficiently.

151.4. The Rebate SKU system was, seemingly, introduced only in South Africa and Zimbabwe where stock control appears to have been problematic, and not in Botswana.

151.5. The allegations concerning the Rebate SKUs at Boitekong[25], if true, are damning. They reveal that the Rebate SKUs were used to hide stock losses rather than for the stated purpose of identifying ROQs.

151.6. It is suspicious that an abnormally large volume of stock recently transferred to Rebate SKUs ostensibly as excess stock, could be quickly and apparently easily sold over the Easter trading period at little or no profit. This is particularly so in

[25] See paragraphs 139 *et seq* above.

circumstances where there were allegations of stock loss, and where a stock count had been scheduled but delayed until after Easter.

151.7. It seems suspicious that between March and May 2018 Choppies paid Devland R123 million and that more or less contemporaneously Devland paid Choppies R128 million for the "bulk stock" (a substantial component of which was cash received from Somali traders).

151.8. The alleged receipt of some R30 million from Somali traders who allegedly paid cash to ANE for on-payment to Choppies is suspicious. The explanation[26] is unconvincing as is the statement that the traders would pay ANE and then go and fetch their purchases from Choppies. In addition there do not appear to be any invoices or receipts to substantiate the payments from Somali traders.

151.9. The relationship between Devland and ANE is also strange. They appear to be referred to interchangeably in Choppies' records. Suffice it to say that these two companies could have been party to the fraudulent concealment of stock losses.

151.10. The EY report demonstrates that a number of perishable items such as bread, eggs and milk were transferred to Rebate SKUs and back to SKUs and then sold over the Easter trading period. A number of these were weeks and in some cases months beyond their sell by dates.

151.11. A number of stores, according to EY, were allegedly stocked beyond capacity.

151.12. The increase in the purchase price for the Zandspruit stores requires investigation. On the one hand, the increase in valuation of the stores by R91 million could be legitimate. On the other, the fact that the valuations were revised only after the

[26] A benefit in not having to pay the fees Choppies' bankers would have charged for cash deposits.

Easter period stock liquidation, and then backdated to make it appear as if they were carried out earlier, suggests that these valuations could have been procured as part of a scheme[27] to hide the stock losses (particularly when one considers that stock losses could, substantially, have been hidden in the value, in the company records, of the four stores that were acquired).

151.13. Finally, conflicting versions are referred to in the EY report. Some Choppies' employees describe the Zandspruit store purchases as being transactions entirely separate from the bulk sales; others state that the sale of bulk stock was "essentially" payment for the Zandspruit stores; certain employees actually say that the Rebate SKU system was used to hide stock losses.

152. What we have referred to above casts significant suspicion on the Easter transactions. While there is insufficient evidence for us to conclude that a fraud has been committed, we believe that it is something that should be the subject of further investigation.

Conclusions on the Easter Transactions

153. The EY report demonstrates that there is a significant possibility that stock losses were fraudulently manipulated in the Company's records. If this is so, then, self-evidently the persons responsible would be guilty of far more than a failure of corporate governance; they would be guilty of knowingly defrauding the company's shareholders by attempting to procure the preparation of annual financial statements that would have misrepresented the worth and trading activities of the Company.

[27] It appears that GT would not have been involved in this.

154. As we have said, on the evidence before us, we can say only that there is a *prima facie* case made out by EY that a fraud has been committed. Whilst we cannot say whether further investigation will reveal the fraudulent manipulation of stock losses we believe that such investigation is required.

The Zimbabwe allegations

Introduction

155. In relation to Choppies' Zimbabwe operations the EY report identifies that:

155.1. a manipulation of stock losses similar to that outlined above could have occurred in Zimbabwe; *and*

155.2. Choppies could have been involved in money laundering.

The stock loss allegations

156. From our analysis of the EY report, it would appear that Choppies Zimbabwe could have used a *modus operandi* similar to that ostensibly used in South Africa to hide stock – using "*Grocery SKUs*"[28] in Zimbabwe as opposed to "*Rebate SKUs*" in South Africa.

157. As mentioned above, on 20 March 2018 the CEL board identified stock losses in SA and Zimbabwe; and a stock count was scheduled for 7 April 2018.

158. Over a period of 7 days (20 to 27 March 2018) Choppies Zimbabwe transferred $7 million worth of stock from Grocery SKUs back to their underlying store SKUs. The

[28] This was the name used in Zimbabwe.

vast majority of these SKUs were ostensibly sold for cash during the 2018 Easter trading period.

159. EY was unable to find proof of these cash receipts; specifically it could not verify the alleged receipt of some $4 million.

160. EY determined that the money ostensibly raised from these bulk sales was allegedly used to pay a company called Fortbuild Contractors (Pvt) Ltd ("***Fortbuild***") to refurbish several Choppies stores in Zimbabwe. However, EY was unable to find substantiation that $3.5 million of the sum realised from bulk sales was in fact paid to Fortbuild.

161. Once again, there is a reasonable probability that the contract with Fortbuild was artificially overvalued to hide stock losses; and Fortbuild would necessarily have been involved in the fraud if fraud there was.

162. Once again, further investigation is warranted.

<u>The money laundering allegations</u>

163. The EY report makes reference to an allegation by a former Choppies Zimbabwe director and shareholder, Mr Siqokoqela Mphoko ("**Mphoko**"), that large amounts of cash were from time to time brought into different stores in Zimbabwe and entered into the records of the stores concerned as sales (when in fact there were no sales).

164. It is alleged that a company Pratosh Investments (Pvt) Ltd ("***Pratosh***") was paid a portion of this money allegedly for produce supplied which was in fact not supplied. It would appear that there is no substance in Mphoko's accusation – EY concluded that Pratosh did indeed supply produce to Choppies Zimbabwe commensurate with the payments it received.

165. Mphoko also made an allegation that some of the illicit money was used to fund the store refurbishments by Fortbuild.

166. Mphoko's allegations are, of course, relevant to the stock loss allegations in that, "money laundering" would depend on funds being paid to and by the Company for a falsely contrived reason. The allegations therefore do bear investigation in relation to stock losses.

The related party allegations

167. The EY report reflects that four of the Company's directors did not declare all of their outside business interests (including directorships of other companies) to the board in circumstances where these should have been disclosed. This would constitute a failure of good corporate governance.

168. Conflicts of interest could potentially arise if directors are associated with entities which do business with or compete with Choppies. Each director has a duty to make a full disclosure of any such interests so that the board is able to assess the extent of the conflict and manage the potential risk associated therewith. Shareholders, too, are entitled to be informed of outside interests disclosed by the Company's directors.

169. EY finds that Ottapathu, for example, has been associated with a supplier to Choppies, Adams Apple (Pty) Ltd ("***Adams Apple***"). EY does not reach any conclusion as to the materiality or severity of this non-disclosure. Nor does it seems that Ottapathu has been called upon to give an opportunity to explain his relationship with Adams Apple.

170. Ultimately, there is not enough information in the body of the EY report for us to comment on whether Ottapathu (or indeed any of the other directors) should be

sanctioned as a result of any non-disclosures. However, Choppies should investigate each of the alleged non-disclosures mentioned in the EY report and assesses the risks, if any, associated therewith. Whether or not action against the directors should follow will depend on, *inter alia*,:

170.1. the extent of the conflict of interest;

170.2. the nature and extent of the relationship between that director's outside interest and Choppies; *and*

170.3. that director's reason for not making the disclosure.

171. The EY report does not identify any directors as having business interests with any of the transacting parties mentioned in this opinion (other than Ottapathu purportedly holding the Fours Group shares in his own name, discussed above). Accordingly, we do not intend dealing with the non-disclosure of business interests in any further detail.

Intra-Group dealings and Ottapathu's remuneration

Introduction

172. In addition to the issues raised in the DLG and EY reports, there seems to have been a failure of corporate governance in relation to two further aspects. The first is the intra-group dealings between Choppies' holding company and its subsidiaries. And the second is the Ottapathu's remuneration.

The intra-group dealings

173. The majority of the Fours Group transactions were concluded by CDC represented by Ottapathu. However, we do not know the basis upon which Ottapathu claims to be

authorised to transact on CDC's behalf (his contract of employment only entitles him to act on behalf of CE – which is the private predecessor to the listed holding company, CEL).

174. We also have no information about the composition of CDC's board of directors; suffice it to say that the boards of the holding company and its trading subsidiary appear to coincide. To illustrate: the minutes which we have been furnished all pertain to CEL whereas they are concerned with the business of CDC.

175. It is of course, fundamental that the affairs of the trading subsidiary be run by its own board and not by the board of the holding company. That said, no point appears to be made of this in either the DLG or the EY report so we shall take it no further. Suffice it to say that this is a matter for the present board to attend to.

176. Ottapathu, as we have said, appears to have been given free rein to run CDC. He appears to have championed the Easter Transactions and the postponement of the stock take until after Easter 2018; in addition the Zandspruit store sale agreements were concluded by him on behalf of Choppies SA.

177. From the evidence we have seen it would appear that little regard was had to the separate legal personalities of CEL's various subsidiaries. This offends against the principles of effective leadership, transparency and compliance. Furthermore, Ottapathu, *de facto* appears, improperly, to have run the trading subsidiaries of CEL to the virtual exclusion of their boards. This has been recognised and we need say no more about it.

178. To state the obvious: It is imperative that proper systems of corporate governance be in place for each of CEL's subsidiaries. Minutes of board meetings must be kept that

properly record the business transacted at those meetings; mandates of the authority conferred on any persons must be issued by the respective boards; and contracts of employment must be entered into with all employees. The board of CEL must review the board minutes of each subsidiary on a regular basis (even if such a review is in broad and general terms).

Ottapathu's salary

179. The high regard with which Ottapathu was held by both the board and the shareholders is reflected in his significant salary of BWP10.5 million per annum (10 times higher than the next executive salary). There would appear to be two failures of corporate governance relating to Ottapathu's remuneration in that:

179.1. Ottapathu sits on the remuneration committee whereas King IV recommends that the CEO should not sit on the remuneration committee; *and*

179.2. the shareholders should be allowed an advisory vote on the Company's remuneration policy (which is apparently not the case).

180. We recommend that CEL's board should implement the above practices (as specified in King IV) when next reviewing Ottapathu's salary.

Overall conclusion, summary of advice, recommendations

181. We have at various points in this opinion specified where there have been failings of good corporate governance. Specifically, there have been failings of reporting, transparency, compliance and the management of risk. The Choppies board has not governed effectively – as we have said Ottapathu appears to have been given free rein without proper oversight to run the trading subsidiaries of CEL across several different countries.

182. While it appears that Ottapathu did not keep his board fully informed about all of his material actions, it would appear that the board did not require him to do so and simply acquiesced in this. As a result, Ottapathu appears to have been the only board member who was involved in and concerned with the everyday running of the business. This resulted in ineffective governance.

183. Nevertheless, we are of the view that none of these failings of governance (with the exception of the stock loss allegations, if true) appear to be so grievous as to warrant action being taken against the directors involved (including Ottapathu). We are instructed that the situation has been recognised and remedied so we need take this no further.

184. To stress the obvious: Choppies ought to undertake a review of its corporate governance structures to ensure compliance with King IV. In particular, systems should be put in place that:

184.1. ensure better reporting to and from the boards of each of its subsidiaries;

184.2. ensure better reporting by its CEO and other senior officials;

184.3. create sitting "investment committees" on the boards of each of its major subsidiaries;

184.4. ensure that all large transitions be first approved by the relevant investment committee and board of directors; *and*

184.5. ensure that the boards of all subsidiaries manage the day-to-day running of the companies rather than leaving this in the hands of the CEO.

185. In addition, we recommend that the Company re-visits its CEO's contract of employment.

186. In relation to the non-disclosure by directors of their outside interests, we recommend that Choppies in due course identifies each of the non-disclosures mentioned in the EY report, assesses the risks associated therewith, and establishes why each director failed to make the appropriate disclosure to the extent that this occurred. This will enable Choppies to determine whether any form of action or sanction should be taken against any particular director.

187. In relation to the Fours Buying Group we are satisfied that, on the evidence before us, there has been no actionable malfeasance by Ottapathu (save for his contribution to certain failures of good corporate governance). The allegation that the buying group has not been disentangled/terminated (contrary to an undertaking given to the CA) has also not been substantiated and is contradicted by the action for the return of the shares.

188. The stock loss allegations (as we have said Ottapathu was intimately involved in the transactions concerned) remain. The EY report establishes a substantially compelling *prima facie* case that stock losses of approximately R200 million have been concealed fraudulently by acquiring stores at inflated prices. This must, in our view, be investigated properly.

189. We would suggest the Company convenes an independent quasi-judicial inquiry to determine the allegations of stock losses in both South Africa and Zimbabwe. Given than such an inquiry would have labour law implications we do not comment on the mechanism of its constitution. That issue will be dealt with by Messrs Redding SC and Meyerowitz in their opinion.

GUY HOFFMAN SC

MARK MEYEROWITZ

Chambers

5 December 2019

Annexure "A"

In re:

CHOPPIES ENTERPRISES LIMITED

GLOSSARY OF TERMS IN CORPORATE OPINION

TERM / ACRONYM	DEFINITION
Adams Apple	Adams Apple (Pty) Ltd
ANE	ANE Western Cape (Pty) Ltd
AODs	Acknowledgments of debt
BSE	Botswana Stock Exchange
CE	Choppies Enterprises (Pty) Ltd (Choppies' private predecessor)
CEL, Choppies or the Company	Choppies Enterprises Limited
CDC	Choppies Distribution Centre (Pty) Ltd
Custody	Custody Investments (Pty) Ltd t/a Fours Cash and Carry, Maun
Devland	Devland Cash and Carry (Pty) Ltd
DLG	Desai Law Group
EY	Ernst & Young Advisory Services (Pty) Ltd
Fortbuild	Fortbuild Contractors Pvt Ltd
GT	The advisory firm Grant Thornton
Henning	Mr Willem Henning
Little	Mr John Little (CEL's company secretary)
Malique	Mr Mohamed Malique (Payless' principal shareholder and sole director)
Mathews	Mr Robert Mathews (CEL's former Audit Committee chair)

Mphoko	Mr Siqokoqela Mphoko (a former Choppies Zimbabwe director and shareholder)
Ottapathu	Mr Ramachandran Ottapathu (CEO of Choppies)
Paruk	Mr Zaheer Paruk (Choppies' South African chief buyer)
Payless	Pay-less Supermarket (Pty) Ltd
Pratosh	Pratosh Investments Pvt Ltd
PwC	Price Waterhouse Coopers
Pritchard	Mr Tom Pritchard (CEL's current audit committee chair)
ROQs	Re-order quantities
Sharpview	Sharpview (Pty) Ltd t/a Fours Cash and Carry, Gaborone
SKUs	Stock keeping units
The 2014 buying agreement	A buying arrangement between CDC, Payless and Woodblock that first began in April 2014
The Fours Group Buying agreement / the 2015 buying agreement	A buying arrangement between CDC, Payless, Sharpview and Custody entered into on 28 September 2015
The 2017 buying agreement	A new buying agreement between CDC, Payless, Sharpview and Custody concluded on 22 April 2017
The 2018 AFS	The Company's audited financial statements for the financial year-end at 30 June 2018
The Abrahams report	An analysis of the EY report prepared by chartered accountant Mr Brian Abrahams on the instruction of Ottapathu dated 26 August 2019
The Act	The Botswana Companies Act Cap 42:01
The board	The Company's board of directors
The bulk sales	The rapid liquidation of bulk stock over the Easter trading period
The CA	The Botswanan Competition Authority
The Circular	A circular to shareholders dated 14 August 2019
The compliance issues	Possible contraventions by Choppies of BSE listing requirements regarding

	related party transactions, as well as possible competition and tax law issues
The disciplinary charges	Disciplinary charges brought against Ottapathu dated 26 August 2019
The disentanglement allegation	An allegation that Choppies breached the joint undertaking given to the CA by CDC and the Fours Group to disentangle itself from its buying arrangement
The Distribution Centre Credit Transaction	As of 30 December 2018 CDC had not received payment from Devland for further SKUs to the value of R27 million
The DLG report	A report dated 3 June 2019 compiled for the board by DLG pertaining to allegations of financial mismanagement by the Company regarding the Fours Buying Group and one of the group's member companies, Payless
The Easter trading period	A period covering March and April 2018
The Easter transactions	The sale of bulk stock by the Company in both South Africa and Zimbabwe over the Easter trading period, as well as the purchase of four stores in South Africa
The EGM	An extraordinary general meeting of shareholders held on 4 September 2019
The EY report	A report on, *inter alia*, the Easter transactions compiled by EY
The Fours Buying Group	A buying entity comprising of, *inter alia*, CDC, Payless, Sharpview and Custody
The joint undertaking	On 22 February 2019 the Fours Group provided the CA with a joint written undertaking that the Fours buying arrangement had been terminated/ disentangled
The sham transactions allegation	The allegation that the Easter transactions were a fraud designed to hide stock losses of over R200 million
The Stock Return	Return of stock ostensibly worth R11 million as against an underlying sale of only R200,000.00

The Zandspruit stores	The four South African stores purchase by Choppies from ANE (specifically, Zandspruit, Cliffy's, Hebron and Bela-Bela)
Woodblock	Woodblock (Pty) Ltd t/a Fours Cash and Carry
Vaduthala	Mr Sunil Vaduthala (Choppies' current head of the data management department)