

DISPUTE RESOLUTION ALERT

IN THIS ISSUE

BUSINESS RESCUE, RESTRUCTURING AND INSOLVENCY:

A COMPANY IN FINANCIAL DISTRESS PRESENTS ITS CREDITORS WITH A COMPROMISE – PITFALLS CREDITORS SHOULD BE AWARE OF

The creditors of a company in financial distress are often faced with various options. A debtor company can either be liquidated, placed in business rescue or enter into a compromise with its creditors without first being placed in liquidation. Although an offer of compromise, at first glance, may seem very attractive to creditors, there may be many pitfalls of which creditors must be aware.

CAN YOU HAVE YOUR CAKE AND EAT IT TOO?

In the case of *BP Southern Africa (Pty) Ltd v Intertrans Earl SA (Pty) Ltd & Others* (34716/2016) [2016] ZAGPJHC 310 (25 November 2016), the court had to consider two important issues: firstly, whether suspension of a contract by the business rescue practitioner in terms of s136(2)(a)(i) and (ii) of the Companies Act, No 1971 of 2008 (Act) suspends not only the obligations of the business rescue practitioner to perform in terms of the contract entered into between the parties, but whether it also suspends the obligations of the other contracting parties.

BUSINESS RESCUE, RESTRUCTURING AND INSOLVENCY: A COMPANY IN FINANCIAL DISTRESS PRESENTS ITS CREDITORS WITH A COMPROMISE – PITFALLS CREDITORS SHOULD BE AWARE OF

Section 155 of the Companies Act, No 71 of 2008 (Act) sets out the procedure to be followed and requirements to be met for a compromise to be proposed to creditors of a debtor company.

The only option available to such creditor is to oppose the sanctioning of the scheme of compromise by the court, which is required to make it final and binding on all the creditors of the company.



The creditors of a company in financial distress are often faced with various options. A debtor company can either be liquidated, placed in business rescue or enter into a compromise with its creditors without first being placed in liquidation. Although an offer of compromise, at first glance, may seem very attractive to creditors, there may be many pitfalls of which creditors must be aware.

Both liquidations, and the subsequent winding up of the affairs of a debtor company by its liquidator, and business rescue proceedings are stringently regulated by legislation and liquidators and business rescue practitioners are subject to oversight by the Master of the High Court (Master) and the Companies and Intellectual Property Commission (CIPC) respectively. The same cannot be said in the case of a company proposing to enter into a compromise with its creditors.

Section 155 of the Companies Act, No 71 of 2008 (Act) sets out the procedure to be followed and requirements to be met for a compromise to be proposed to creditors of a debtor company. The majority of the provisions of s155 relate to formal and procedural requirements, and once the requisite majority vote has been obtained at a meeting convened for this purpose, there is little left for a disgruntled creditor to do. The only option available to such creditor is to oppose the sanctioning of the scheme of compromise by the court, which is required to make it final and binding on all the creditors of the company. To be

successful with such opposition, a creditor must show that it would be just and equitable for the court to reject the scheme - not an easy burden to meet. Having already compromised its claim where the majority of the debtor company's creditors voted in favour of the compromise, is a minority creditor to then still approach a court, incur legal costs, to try and make out a case that the compromise is not just and equitable with a substantial evidential burden in proving this?

Should creditors be presented with a compromise by a debtor company, it may at first sight seem like a "quick-fix" and easy way to acquire immediate financial relief for a portion of its debt, however, there are a few factors weighing against voting in favour of a compromise. In a compromise, creditors will indirectly be held liable for the costs to pay the receiver, appointed to administer all the claims of the creditors of the debtor company and the compromise process, despite such receiver not being subject to the same legislative regulation or oversight required from the Master and CIPC.

Tim Fletcher was named the exclusive South African winner of the **ILO Client Choice Awards 2017** in the litigation category.



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CONTINUED

Creditors, who receive an offer of compromise, must seek legal advice on the terms of the compromise before deciding whether to vote in favour of such compromise.



The consequences of a compromise are not too different from that of the adoption of a business rescue plan, being that creditors in both instances, if they vote in favour of the compromise or business rescue plan, will compromise their claims against the debtor company and will have no further claims against the debtor company in terms of that specific debt. One major disadvantage of a compromise is the loss of a creditor's right to hold officers and directors liable for any contravention of the Act. A compromise is, however, in one instance more beneficial than business rescue: the Act makes provision for a creditor to retain its right to go against the surety of the debtor company.

Creditors can conceivably waive their rights in terms of the proposed compromise, to proceed against the directors in terms of s424 of the old Companies Act, No 61 of 1973 (Old Act) in regard to reckless trading by the director pre compromise. Creditors will have no investigative power, through the receiver of the debtor company, to investigate reckless or negligent conduct of officers and directors of the debtor company. A compromise can therefore be a safeguard for reckless officers and directors to

avoid any liability. There will also not be any opportunity for creditors to have a transaction, liable to be set aside in terms of insolvency legislation, investigated and set aside. Therefore, if there are facts to substantiate a possible successful enquiry in terms of s424 of the Old Act, then creditors are advised to vote against the compromise and rather institute an application for the winding up of the company. A liquidator, unlike a business rescue practitioner, has the necessary powers to investigate the dealings of the company prior to liquidation and where necessary, to set aside any transactions which may be voidable or seek to hold the directors of the company liable in the event of fraud, reckless trading or other contravention of the law.

Creditors, who receive an offer of compromise, must seek legal advice on the terms of the compromise before deciding whether to vote in favour of such compromise, or rather apply to court to commence business rescue proceedings or if the facts are evident that the company is unable to pay its debts, apply to court to wind-up the debtor company.

*Mari Bester,
overseen by Lucinde Rhodie*

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The business rescue practitioner suspended, in terms of s136(2)(a)(i) and (ii) of the Act, all the obligations on the Company to perform in terms of any agreement including the agreement between BP and the Company.

The court held that the suspension of all the Company's obligations under the agreement in terms of s136(2)(a) would entitle BP to withhold access to the leased premises.



In the case of *BP Southern Africa (Pty) Ltd v Intertrans Earl SA (Pty) Ltd & Others* (34716/2016) [2016] ZAGPJHC 310 (25 November 2016), the court had to consider two important issues: firstly, whether suspension of a contract by the business rescue practitioner in terms of s136(2)(a)(i) and (ii) of the Companies Act, No 1971 of 2008 (Act) suspends not only the obligations of the business rescue practitioner to perform in terms of the contract entered into between the parties, but whether it also suspends the obligations of the other contracting parties. Secondly, what effect the suspension of obligations had on the cession of debtors in respect of debts which arose after the commencement of business rescue.

The salient facts of the case are as follows:

- the applicant, BP Southern Africa (Pty) Ltd (BP) and the first respondent, Intertrans Oil SA (Pty) Ltd (Company) entered into various agreements in terms of which the Company would have the right to exclusively purchase BP's products for resale and BP would supply the Company with fuel and lease its premises to the Company;
- as security, the Company ceded to BP all of its debtors, past and future, however, arising;
- the Company adopted a resolution to place itself into business rescue;
- the second respondent, the business rescue practitioner was appointed;
- the business rescue practitioner suspended, in terms of s136(2)(a)(i) and (ii) of the Act, all the obligations on the Company to perform in terms of any agreement including the agreement between BP and the Company;

- the business rescue practitioner also adopted the attitude that all cession of debtors was unlawful, invalid and unenforceable. In the alternative, the business rescue practitioner argued that his suspension of all the Company's obligations, meant that the Company had no obligations under the cession of debts in respect of debts that arose in business rescue; and
- BP thus attacked the conduct of the business rescue practitioner.

The court stated that although the section is silent about the effect that such suspension would have on the obligation of the other contracting party, it must be accepted that the other contracting party always has their common residual rights in terms of the law of contract available, including the normal rights of cancellation.

Accordingly, the court held that the suspension of all the Company's obligations under the agreement in terms of s136(2)(a) would entitle BP to withhold access to the leased premises. However, the court noted that BP must ensure that it



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CONTINUED

The court held that a cession of future book debts is, in our law, complete and effective by the mere agreement.



complied with the notice and cancellation provisions in terms of the suspended agreement in order to cancel it. As such, the business rescue practitioner cannot simply suspend obligations due in respect of contracts, yet expect performance thereunder by the other contracting parties.

The next issue which the court had to consider was the status of the cession of book debts, given that the business rescue practitioner argued that any debts arising after the suspension of the contract constituted debts which would not form part of the cession of debtors and was capable of being used to rescue the business.

In respect thereof, the court held that a cession of future book debts is, in our law, complete and effective by the mere agreement thereto. When at the future date the book debts come into existence, they become the property of the cessionary without any further obligation being placed on the cedent.

As such, the court held that there was no obligation of the company arising from the cession of book debts that was capable of being suspended by the business rescue practitioner. As such, the court held that any debts which arose during the business rescue proceedings were also ceded to BP and could not be disposed of without the BP's consent as provided for in s134 of the Act, as such book debt constituted security held by the applicant.

Julian Jones and Roxanne Wellcome

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