DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

# NEWSLETTER

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CDH
CLIFFE DEKKER HOFMEYR

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Business Rescue,
Restructuring &
Insolvency

As we recently welcomed in a new season of Spring, in true 2020 fashion it didn't quite meet the usual Spring standards with the first two days being some of the gloomiest days we've had this year. Nevertheless, Spring has sprung and finally reared its head and we can now start to look forward to the prospect of a hopeful Summer.

Just as we have welcomed the new season of Spring, it has been interesting to see another season develop in the insolvency and business rescue sector. There seems to have been a boom and an "*open season*" declared on the purchasing of distressed assets/businesses. During this season we have seen many investors taking advantage of the distressed sales of companies and businesses who have found themselves in distressed circumstances as a result of the effects of the COVID-19 pandemic.

As such, we wish to consider the requirements in determining the voting rights and interests required in terms of the Companies Act, 2008 (the Act), in order to amend a business rescue plan or adjourn a section 151 meeting. This is important to understand in this season as competing bids for distressed companies are often the topic of discussion in creditors meetings and a large consideration in a business rescue plan where the prospect of rescue of a business relies on the sale thereof.

There has been much contention regarding the interpretation of the voting rights as provided for in section 152, read with section 151, of the Act, and so we hope to unpack this in this latest edition.

We then look to an interesting judgment involving the notorious BOSASA group of companies. The mammoth judgment was handed down on 24 August 2020 and comprised of an order(s) relating to the three applications that the court had to consider over a two-day videoconference hearing – in true COVID-19 fashion.

The judgment speaks to the powers extended to provisional liquidators in circumstances of liquidations, auctions and the like; the judgment further considers the on-going debate as to when a business rescue application is in fact 'made'.

We trust that this edition and the contents herein will assist you in navigating through this next chapter of 2020, and if nothing else, you can enjoy the convenience of reading the summarised version of the BOSASA judgment rather than that of the 100 page judgment.

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# Is a simple majority sufficient to amend a business rescue plan or to adjourn a meeting?

In terms of section 151 of the Companies Act 71 of 2008 (Companies Act), a business rescue practitioner (BRP) must convene and preside over a meeting of creditors within 10 days after the proposed business rescue plan (BR Plan) was published, in order to consider the BR Plan (Section 151 meeting).

At a Section 151 meeting, a BRP must:

(i) Introduce the proposed BR Plan for consideration by the creditors and, if applicable, by the shareholders;

(ii) Inform the meeting whether the BRP continues to believe that there is a reasonable prospect of the company being rescued;

(iii) Provide an opportunity for the employees' representatives to address the meeting;

(iv) Invite discussion, and entertain and conduct a vote, on any motions to:

- Amend the proposed plan, in any manner moved and seconded by creditors, and satisfactory to the practitioner; or
- Direct the BRP to adjourn the meeting in order to revise the BR Plan for further consideration.

(v) Call for a vote for preliminary approval of the proposed BR Plan, as amended if applicable.

Whereas the Companies Act specifically states that a proposed BR Plan will be approved on a preliminary basis if: (i) it was supported by the holders of more than 75% of the creditors' voting interest that were voted; and (ii) the votes of the proposed plan includes at least 50% of the independent creditors' voting interests that were voted, there is no direct indication in the Companies Act as to what majority is required to amend the BR Plan or to adjourn the meeting where the BR Plan was put to a vote.

The aforesaid lacuna has created legal uncertainty, which will in all likelihood result in future disputes, since parties tend to interpret legislation in a manner that is the most advantageous towards them.

# Is a simple majority sufficient to amend a business rescue plan or to adjourn a meeting? *...continued*

## Potential interpretations

We are of the view that parties could potentially argue that the following different majorities are required in order to amend the BR Plan or to adjourn the meeting:

(i) 75% of the creditors' voting interest that were voted; and (ii) at least 50% of the independent creditors' voting interests that were voted;

(ii) A simple majority of the independent creditors' voting interests; and

(iii) A simple majority of the creditors' voting interest.

## 75% of the creditors' voting interests and 50% of the independent creditors' voting interest

A number of South African academics argue that 75% of all creditors' voting interests and 50% of the independent creditors' voting interest are required in order to pass a motion to amend a BR Plan or to adjourn the meeting. However, there are a number of interpretational difficulties with this interpretation. The most evident difficulties are:

- Section 152(1)(d)(i) of the Companies Act specifically refers to "holders of ***creditors' voting interests***". This is similar to the wording used in the first stage of the two-stage approach in section 152(2) of the Companies Act (i.e. 75% of the **creditors' voting interests** that were voted). However, unlike section 152(2) of the Companies Act, there is no mention of the second stage of the two-stage approach, namely, the 50% **independent creditors' voting interest** that were voted.
- Section 152(2) of the Companies Act specifies that the subsection applies to votes called in terms of **section 152(1)(e)** of the Companies Act. In light of the aforementioned, it will be difficult to argue that section 152(2) of the Companies Act must be used to determine the majority required in order to pass motions in terms of section 152(1)(d) of the Companies Act.
- In terms of this interpretation, in order to amend a proposed BR Plan or to force a BRP to publish a revised BR Plan (in terms of section 153(1)(b)(i)(aa) of the Companies Act), you will require the same majority that is required in order to ultimately approve the BR Plan. This will make it unnecessarily difficult for creditors to get a proposed BR Plan amended.

## A simple majority of the independent creditors' voting interests

Another potential interpretation is that a simple majority of the independent creditors' voting interest is required in order to amend the BR Plan or to adjourn the meeting.

However, since section 147(3) of the Companies Act specifically states that a simple majority of the independent creditors' voting interests will only be required to pass motions at meetings of creditors **other than section 151 meetings (where the BR Plan is put to a vote)**, and since motions in terms of section 152(1)(d) of the Companies Act will be considered at section 151 meetings, it is clear that the legislature didn't intend the independent creditors' voting interest to be taken into consideration.

## A simple majority of the holders of creditors' voting interest

A further interpretation is that a simple majority of all the holders of creditors' voting interest will be sufficient to pass motions in terms of section 152(1)(d) of the Companies Act. This is the approach that is followed by BRPs.

In practice, this will mean that the same creditors who could vote in terms of the first stage of the two-stage approach on the adoption of the BR Plan, would be able to vote to pass the motions to amend the plan or to adjourn the meeting. The only difference is that now, instead of requiring a 75% majority (as per section 152(2) of the Companies Act), a simple majority will be sufficient to pass these motions.

We are of the view that this approach is the correct approach, as long as the following requirements are also met:

(i) The motion must be proposed by one of the holders of creditors' voting interest (it doesn't matter what percentage of the creditors' voting interest the creditor holds);

(ii) The motion must be seconded by another holder of creditors' voting interest (it also doesn't matter what percentage of the creditors' voting interest the creditor holds); and

(iii) The BRP must be satisfied with the proposed amendment.

Lastly, since the proposal to amend the BR Plan must be satisfactory to the BRP, it could potentially be argued in the future that the BRP has a veto right and that if he/she is not satisfied with the proposed amendment/adjournment, he/she could set aside the vote.

## Conclusion

The fact that the Companies Act is drafted in a manner where there is no clarity regarding the majority required in order to amend a BR Plan or to adjourn a meeting where the BR Plan is put to a vote, creates legal uncertainty. This will undoubtedly result in disputes, especially where competing bids for distressed assets are often, and even more so in the current economic climate, the topic of discussion at meetings of creditors. This legal uncertainty will hopefully be dealt with by the South African courts in due course.

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# The BOSASA saga continues – important legal considerations

Earlier this year, de Villiers AJ was faced with the mammoth task of hearing before him a matter involving various companies as part of the African Global Holdings group – formerly/ commonly referred to as BOSASA group of companies. The matter comprised of a business rescue application of six companies in liquidation (the business rescue application); an application to set aside the sale of assets of the six companies (the auction application); and an application to vary a court order pertaining to the sale of an immovable property of one of the six companies (the rule 42 application).

This already mammoth task was taken on and heard by the Gauteng Local Division, Johannesburg (the court) via videoconference due to the constraints which were presented by COVID-19.

Due to the interrelatedness of the three above-mentioned applications (they all relate to the affairs of the BOSASA group of companies), all three of the applications were argued over two days as one hearing wherein Judge de Villiers sought to deal with the issues as presented by each application as a whole.

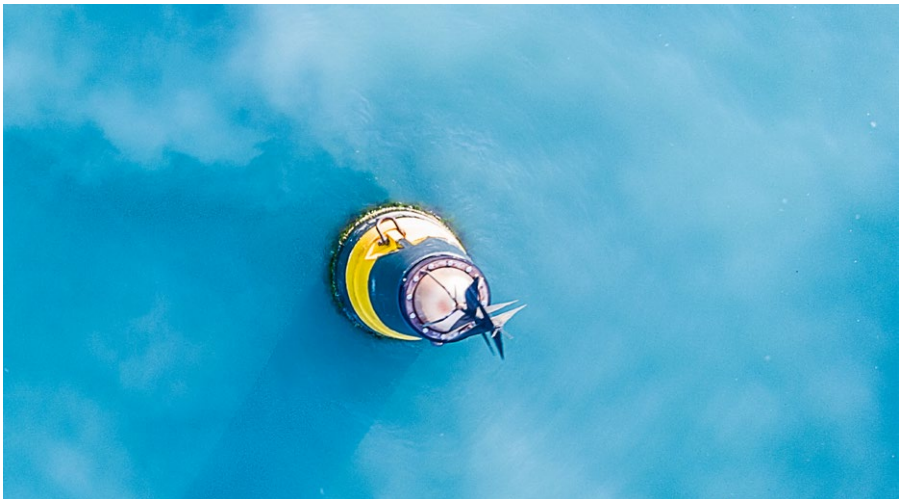
The three applications (and the relief sought) can be summarised as follows:

1. In the business rescue application, the applicants, being the African Global Holdings (Pty) Ltd (African Global Holdings), Sun Worx (Pty) Ltd and Kgwerano Financial Services (Pty) Ltd (the latter two parties being creditors and interested parties) sought to place the six companies in liquidation (the six companies) under supervision and that business rescue proceedings be commenced in terms of section 131(1) of the Companies Act 71 of 2008 (the Act) and to appoint a business rescue practitioner accordingly;
2. In the auction application, the applicants (same as the applicants in the business rescue application) sought to set aside the sale of the assets of the six companies by the provisional liquidators and to prohibit any auction of and any other sale of assets of the six companies; and

# The BOSASA saga continues – important legal considerations...*continued*

3. Fidelity Security Services (Pty) Ltd (Fidelity), one of the purchasers of immovable property at the liquidation auction, brought a rule 42 application to vary the order granted in a previous hearing dated 28 October 2019 (Bhoola order) wherein Fidelity believed that Boohla J had mistakenly not included the extension of power to the provisional liquidators to sell immovable property it had purchased.

Judge de Villiers identified and dealt with various issues in determining the interrelated applications. The most important issues (from a business rescue and insolvency perspective) and the legal principles relating thereto are discussed hereunder.



## Legal issues

### *Whether the business rescue application was in fact 'made'*

In terms of section 131(6) of the Act, if liquidation proceedings have already been commenced by or against the company at the time that a business rescue application is "*made*" in terms of section 131(1) of the Act, the business rescue application will suspend those liquidation proceedings.

The court had to consider whether or not the business rescue application had been properly "*made*" and if so, when this occurred.

The provisional liquidators took the point that the business rescue application could not be considered because it had not been "*made*" as contemplated in section 131 of the Act, and further that the auction in the liquidation proceedings could have continued as normal until the application was properly "*made*". The provisional liquidators argued that an application for business rescue is not "*made*" until it is served and given notice of to all parties in the prescribed manner, including as prescribed by regulation 124 of the Companies Regulations 2011 (the Regulations).

After a contextual analysis of the relevant sections in the Act, the court found that the Act does not specify **when** an application is made. However, section 131(1) of the Act states that "*an affected person may apply to a court at any time*" for an order placing the company in business rescue. Section 132(1)(b) states that business rescue proceedings begin when "*an affected person applies to the court for an order placing the company in business rescue*". The keywords in section 131(6) are "*at the time an application is made in terms of subsection (1), the application will suspend …*". These words must be read with the words "*business rescue proceedings begin when … an affected person applies to the court*" in section 132(1)(b) and "*apply to court*" in section 131(1).

The court referred to the authoritative case of *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* (2013) (6) SA 540 (WCC) (Blue Star Holdings) wherein the court held that, applying the functional approach to section 131(6), it is obvious that "*the lodging of the application with the registrar for the issue thereof constituted the 'making' of the application and the commencement of proceedings to place the company under business rescue (as opposed to the commencement of business rescue per se).*"

The court agreed with this view and held that the finding is in accordance with the long-established principles in our law that an application is made when it is issued. Such interpretation further gives effect to the purpose of the Act as set out in section 7(k) which provides, *inter alia*, for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders. The court held that the suspension of winding-up proceedings immediately upon issuing of the business rescue application gives effect to such purpose in 7(k) of the Act.

The court then considered certain case law that came to contrary findings to the one made in Blue Star Holdings. This contrary case law found that no application had been 'made', since the business rescue application had not been properly served and notification of the application had not been given to affected parties. This contrary case law also found that service of a copy of the application on the CIPC and notification to each affected person are not merely procedural steps but are rather substantive requirements, compliance with which is an integral part of the making of an application for an order in terms of section 131(1) of the Act. Judge de Villiers however respectfully disagreed with these findings. The judge indicated that there is a difference between when the business rescue application is "*made*" for it to suspend winding-up, and whether the application is properly before a court when the business rescue application is argued on its merits.

# The BOSASA saga continues – important legal considerations...*continued*

The court concluded that although there must be substantial compliance before a hearing of the application, this does not mean that no application has been made whilst such service and notice is being effected on all affected parties. Based on a contextual interpretation of the legislation, an application is "*made*" when it is issued. The court indicated that the wording of section 131(6) is clear and leaves no room for adding conditions thereto in an interpretative exercise. In addition, the date of issuing of an application is easily and objectively determinable; it is a line in the sand that has logic to it. It leaves no room for a provisional liquidator to refuse to comply with the application until proven to him/her that formal service has taken place and that he/she is has been satisfied that notice has been given to every affected party.

Although the court ultimately did not grant the business rescue application (on the grounds that there were no reasonable prospects of rescue for the businesses), the court held that the business rescue application had in fact been properly "*made*" on the date that it was issued.

### *Provisional liquidators' powers*

The court had to determine whether the provisional liquidators had the power to continue to sell the assets of the six companies in light of section 131(6) of the Act (i.e. after the business rescue application had already been made) and further whether they ever had the power to sell the assets in light of the conditions in the Bhoola order.

The court found that the provisional liquidators had no authority to continue with the sale of the assets of the six companies from the day that the business rescue application was made, by operation of law. This appears from section 131(6) of the Act which provides that once the business rescue application is made, the liquidation proceedings are suspended.

The court then considered the powers of the provisional liquidators in terms of the Bhoola order also generally.

The court highlighted the case of *GCC Engineering (Pty) Ltd and Others v Maroos and Others* 2019 (2) SA 379 (SCA), which stated that a provisional liquidator's duty was that of a holding, preservation function, and that provisional liquidators do not have the power or the responsibility of a final liquidator to wind up the company (the court remarked that provisional liquidators have an interim role only). Therefore, any powers they may receive over and above a holding function must be seen in terms of a court order.

This was seen in terms of the Bhoola order, however, the provisional liquidators' powers were qualified by conditions, one of which being that consent had to be obtained by the boards of African Global Holdings and African Global Operations (Pty) Ltd to sell the assets of the companies in liquidation. This consent was not obtained and the assets were realised by the provisional liquidators regardless of the Bhoola order requiring the consent. The court held that the provisional liquidators breached the obligation to seek consent and that they were therefore in contempt of the court order.

Furthermore, in considering the fact that a business rescue application suspends the process of continuing with the realisation of the assets of the company in liquidation (from the moment the application is made/issued), the provisional liquidators actions in realising such assets were further in contempt.

# The BOSASA saga continues – important legal considerations...*continued*

The court concluded that on both grounds, the first being the effect of a business rescue application having been made on liquidation proceedings (in terms of section 131(6)), and the second being the interpretation of the Bhoola order, the provisional liquidators had no authority to proceed with the sale of assets at the respective auctions.

### *Effect of the unauthorised auction*

As a result of this finding, the court then had to determine the effect of the unauthorised auction.

Fidelity requested the court to use its powers under section 388 of the Companies Act 61 of 1973 (the 1973 Act) to order that, despite the provisional liquidators' lack of authority to sell the assets bought by Fidelity, to validate the sales on the basis that it would be "*just and beneficial*" to do so. The court found that it cannot do so as the provisional liquidators ignored the impact of section 131(6) of the Act and deliberately contravened the Bhoola order. The court stated that section 388 of the 1973 Act "*is inapplicable where the provisional liquidators deliberately acted unlawfully.*"

The court however appreciated the "*huge*" impracticalities of setting aside the sale of assets, especially considering that delivery of most of the assets had already taken place and the purchase price paid.

The practical considerations of the principles in law is that the rei vindicatio of the owner trumps other later rights of *bona fide* possessors (*ubi rem meam invenio ibi vindico*), and that no one could transfer more rights than what she or he has (*nemo dat quod non habet*).

Fidelity also tried to rely on section 82(8) of the Insolvency Act 24 of 1936 (Insolvency Act) to demand transfer by arguing that Fidelity is a *bona fide* purchaser protected by this section.

The court stated that the purpose of section 82(8) is to protect *bona fide* purchasers of assets against harsh consequences of invalidity in terms of the Common Law. Winding-up sales, unlike sales in execution, are special types of sales, where there is room to consider the position of the innocent purchaser. The court also found that section 82(8) of the Insolvency Act applies to a sale by a provisional liquidator where such a power is sought to be exercised in terms of a court order, and the provisional liquidator fails to adhere to the terms of the court order, or fails to give effect to the effect of the business rescue application on the winding-up process.

However, the court held that where transfer has not yet taken place, a purchaser cannot contend that she/he/it "*has purchased*" the property and is thus entitled to protection under section 82(8), since "*has purchased*" in section 82(8) can be interpreted to mean that delivery also taken place. The court held that Fidelity is no longer a *bona fide* purchaser and has no cause of action to demand transfer with regard to purchased, but not transferred, immovable property.

The court set aside the sale of the assets and ordered that any further sale is prohibited.

### *Bad faith/abusive applications*

The court dealt with the averments made by the provisional liquidators that the business rescue and auction applications before the court were brought in bad faith and as an abuse of proceedings. Judge de Villiers indicated that he was unpersuaded that the applications brought before him were an abuse. Although the business rescue application was dismissed, the court found that the application was arguable in accordance with the test to be applied.

The court remarked that had the business rescue application been brought in bad faith, it would have been dismissed. The court stated that the SCA has previously ruled what the remedy is of a business rescue application that is brought in bad faith, which is that the court must dismiss the application without merit. The court referred to the case of *Richter v Absa Bank Limited* 2015 (5) S 57 (SCA) which held that a court can dismiss any application for business rescue that is not genuine and *bona fide* or which does not establish that the benefits of a successful business rescue will be achieved.

### *Merits of the business rescue application*

It was common cause that all six companies were financially distressed.

The court held that the six companies are not viable companies in respect of which a case has been made out that there is a reasonable prospect for rescuing them.

## Conclusion

The judgment deals with and ventilates important legal principles that relate to business rescue and insolvency law.

Importantly, the judgment highlights that an application is "*made*" on the date of issuing the application. On this date, any liquidation proceedings are automatically suspended in terms of section 131(6) of the Act. Furthermore, once liquidation proceedings are suspended, any sales of assets of the company must also be suspended, pending the adjudication of the business rescue application.

Section 131(6) of the Act opens the door to an abuse of process and may result in opportunistic business rescue applications that are brought merely to have the effect of the section 131(6) suspension triggered, with the ulterior motive to stagnate liquidation proceedings. However, a court has the power to dismiss any business rescue application that is not genuine and *bona fide* or which does not establish that the benefits of a successful business rescue will be achieved.

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**BBBEE STATUS:** LEVEL TWO CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.




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