DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

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CDH
CLIFFE DEKKER HOFMEYR

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Business Rescue,
Restructuring &
Insolvency

Just two days prior to the 75th anniversary of the atomic bombings of Hiroshima and Nagasaki, 2020 saw another explosion which shook the world. Two explosions occurred in Beirut, the capital of Lebanon, killing over 200 and injuring thousands, further leaving an estimated of 300,000 people homeless.

Are we currently at war? It certainly feels that way, especially if we compare the devastation brought about by the atomic bombings at Hiroshima and Nagasaki to the devastation that COVID-19 has left in its path.

Much like after a time of war, the effects thereof linger for much longer than the war itself and there is a lot of rehabilitation and rebuilding that needs to take place. As Bertrand Russel said, "*War does not determine who is right – only who is left*" – and it's up to those who are left to rebuild and adapt.

Looking at the gloomy side of this metaphor, we have seen many businesses plummet during this pandemic, many jobs lost, and livelihoods threatened as the endeavour for preservation of life has necessitated sacrifices to be made globally. However, where many have likened this pandemic to that of a war, it is also important to note that through war, ideologies eventually collapsed and new ideas about capital, entrepreneurship and social bonds emerged. COVID-19 has demanded urgent efforts with high stakes and has united people across the world. We have already seen an acceleration in huge global changes which could last for years to come. There has also been a demand for technological advancement and social change in a very short space of time which has thrust our development as a globe in a sharp upward trajectory.

As we move into a more functioning economy (and with rumours floating around of the doors to level 2 being opened shortly), many industries who seemed to have come out of the COVID slump almost unscathed, are struggling to tackle the COVID hangover which has infiltrated the economy and businesses alike. While businesses are forced to consider drastic measures during these difficult times, it is important to consider the ramifications of our actions as these, like war, can have long lasting effects.

In this edition, we consider inter-group provision of security and dispositions without value. Creditors should be wary of financial assistance being offered by inter-group companies as the assistance could be regarded as dispositions and possibly also be set aside.

The pandemic has caused some great hardship across industries and economies. However, there has been some advancement that has come from fighting this 'war'. And so, while we gear up to weather the aftermath of its affects, we must at all times ensure that whilst we adapt, our actions are within the parameters of the law and that we follow good practice.

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Providing security and dispositions without value

In terms of section 26 of the Insolvency Act, 1936, a disposition without value may be set aside by a court if certain requirements are met. Section 2 of the Insolvency Act defines a disposition as any transfer or abandonment of rights to property excluding dispositions made in compliance with a court order.

Guarantees, indemnities and suretyship agreements all fall within the ambit of a disposition and are subject to section 26 of the Insolvency Act. A disposition without value is any transfer or disposal of a right to property, excluding those mandated by a court order, for no value or for a consideration less than the risk incurred by the insolvent in the relevant transaction. The Court has the discretion to set aside a disposition without value if it can be proved that immediately after the disposition the insolvent's liabilities exceeded its assets.

A liquidator may apply to the High Court to have a disposition made for no value set aside if the disposition in question was made by the company (i) more than two years before its liquidation and it can be proved that the company's liabilities exceeded its assets at the time of the disposition, or (ii) within two years of the liquidation of the company and the person who benefited from the disposition cannot prove that the company's assets exceeded its liabilities immediately after the disposition. Whether a disposition is made for no value turns on whether the insolvent company obtained a benefit from making the disposition.

Providing security and dispositions without value *...continued*

In the case of *Langeberg Kooperasie Bpk v Inverdoorn Farming* 1965 (2) SA 597 AD (Langeberg), it was stated that the test for whether a disposition is made for value is whether it can be fairly said that the person providing a guarantee, indemnity or suretyship received an adequate return for making the disposition under the circumstances. In *Umbongintwini Land and Investment Co (Pty) Ltd (In Liquidation) v Barclays National Bank Ltd and Another* 1987 (4) SA 894 (AD) the test for whether a disposition was made for value is whether there was a genuine commercial transaction with the expectation of some advantage at the time the transaction is entered into, which is equal to or more than the risk incurred by the party providing the security.

An issue arises where a company provides security through a guarantee, indemnity or suretyship for the obligations of another company in the same group of companies. If there is no direct or indirect benefit for the company providing the security and their liabilities exceed their assets immediately after the disposition, the security agreement may be set aside and the entity in whose favour the security was given will no longer have a claim against the company in liquidation.

A consideration accepted by our courts, is the financial stability of the group of companies. However, there is no rule of general application in our law that providing security for another company in the same group of companies is a disposition made for value. In the Langeberg case, a subsidiary bound itself as surety and co-debtor for the debts of its parent company and registered a mortgage bond in favour of its parent's creditor. The liabilities of the company were greater than its assets immediately after it registered the mortgage bond. The company argued that the value it received was avoiding its own liquidation because the liquidation of its parent company would

Providing security and dispositions without value *...continued*

ultimately result in the liquidation of all its subsidiaries. The court found that by providing security to its parent company, the company had placed itself in a position where it was unlikely to be able to pay its debts. Therefore, the risk incurred by the company was greater than the advantage received. The court held that the disposition was not made for value and the suretyship and mortgage bond were set aside.

During these tumultuous and challenging times we find ourselves in, a company may want to offer security to other group company to assist the particular company with weathering the COVID-19 storm and for the particular company to avoid becoming financially distressed or eventually being liquidated. Creditors must carefully consider these acts of kindness, as it may constitute a disposition that may be set aside. A creditor may accept security from a company thinking that its rights are fully secured, only for the creditor to find itself in a position where the security agreement is set aside and the creditor in whose favour the security was given no longer has a claim against the company in liquidation.

We recommend that, should a creditor be considering taking certain security for its claim against a particular company, that the creditor first consults with us to ensure that the correct steps are taken, that the creditor's rights are fully protected and that the creditor is not exposed to a situation where the security agreement is set aside, leaving the creditor in a worse off position.

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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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